No.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

DOCTOR'S ASSOCIATES, INC. and NICK LOMBARDI,

Petitioners,

vs.

PAUL CASAROTTO and PAMELA CASAROTTO,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF MONTANA

PETITION FOR A WRIT OF CERTIORARI

MARK R. KRAVITZ*
JEFFREY R. BABBIN
WIGGIN & DANA
One Century Tower
P.O. Box 1832
New Haven, Connecticut 06508-1832
(203) 498-4400

H. BARTOW FARR, III
FARR & TARANTO
2445 M Street, N.W.
Washington, D.C. 20037
(202) 775-0184

* *Counsel of Record*

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QUESTION PRESENTED

Whether Section 2 of the Federal Arbitration Act (9 U.S.C. § 2)--which makes written agreements to arbitrate "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract"--preempts a state law that makes agreements to arbitrate, but not other agreements, unenforceable unless a specific notice of the arbitration agreement is placed on the first page of the contract.

STATEMENT PURSUANT TO RULE 14.1(b)

Daniel L. Hudson, Deb Hudson, and D&D Subway Corporation are parties to the proceedings in the Montana Eighth Judicial District Court. They were not parties to the appeal in the Supreme Court of Montana and are omitted from the caption in this Court.

Doctor's Associates, Inc., the only corporate petitioner, states that it has no parent company and that it has no subsidiaries (other than wholly-owned subsidiaries).

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Doctor's Associates, Inc. and Nick Lombardi respectfully request that a writ of certiorari issue to review the judgment of the Supreme Court of Montana in this case.

OPINIONS BELOW

The opinion of the Supreme Court of Montana has not yet been reported. It is reprinted in the appendix to this petition at 1a-10a. The prior opinion of the Montana Supreme Court in this case is reported at 268 Mont. 369, 886 P.2d 931. It is reprinted in the appendix to this petition at 11a-46a. The order of the Montana Eighth Judicial District Court is not reported. It is reprinted in the appendix to this petition at 49a-50a.

JURISDICTION

The Supreme Court of Montana entered judgment on August 31, 1995. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1257(a).

STATUTORY PROVISIONS INVOLVED

Section 2 of the Federal Arbitration Act, 9 U.S.C. § 2, provides:

> **Validity, irrevocability, and enforcement of agreements to arbitrate**
>
> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

Section 27-5-114(4), Montana Code Annotated, provides:

> Notice that a contract is subject to arbitration pursuant to this chapter shall be typed in underlined capital letters on the first page of the contract; and unless such notice is displayed thereon, the contract may not be subject to arbitration.

The full text of Section 27-5-114, which governs the validity of arbitration agreements under Montana law, is set out in the appendix to this petition. Pet. App. 51a.

STATEMENT

A. Introduction

This is the second time that this case has come before this Court. The case arises from the refusal of the Montana

Supreme Court to enforce an agreement by the parties to arbitrate their disputes. Although the agreement met all of the requirements of Section 2 of the Federal Arbitration Act ("FAA"), 9 U.S.C. § 2--which makes arbitration agreements "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract" -- the Montana Supreme Court, in its initial opinion dated December 15, 1994, held that the agreement was unenforceable because it did not comply with a provision of Montana's arbitration act requiring notice that a contract is subject to arbitration to be typed in underlined capital letters on the first page of the contract. *See* Mont. Code Ann. § 27-5-114(4) (1993). In so doing, the court rejected Petitioners' argument that the Montana statute, which applies only to agreements to arbitrate and not other agreements, is preempted by Section 2 of the FAA.

On June 12, 1995, this Court granted Petitioners' petition for a writ of certiorari, vacated the judgment of the Montana Supreme Court, and remanded the case to that court for further consideration in light of this Court's recent decision in *Allied-Bruce Terminix Companies v. Dobson*, 115 S. Ct. 834 (1995). *See Doctor's Associates, Inc. v. Casarotto*, 115 S. Ct. 2552 (1995). Despite this Court's decision to vacate the judgment in light of *Terminix*, the Montana Supreme Court concluded on remand that "we can find nothing in the [*Terminix*] decision which relates to the issues presented to this Court in this case." Pet. App. 6a. The court thus "reaffirm[ed] and reinstate[d]" its December 1994 opinion. Pet. App. 7a. Because *Terminix* makes clear that a state may not invalidate an agreement to arbitrate under a state law--like Montana's--that places arbitration clauses on an unequal footing with other contract terms, *see* 115 S. Ct. at 838-39, 843, Petitioners again seek certiorari to review the judgment below.

B. Factual Background

Petitioner Doctor's Associates, Inc. ("DAI") is the national and international franchisor of Subway sandwich shops.[1] DAI has sold a total of over 8,500 Subway franchises throughout the United States. Pet. App. 49a; *see also id.* 37a (Weber, J., dissenting). Petitioner Nick Lombardi is DAI's development agent in Montana.

On April 25, 1988, respondent Paul Casarotto entered into a franchise agreement with DAI to open a Subway shop in Montana. Pet. App. 13a. The franchise agreement was a standard agreement used by DAI with its franchisees. The agreement contained an express arbitration clause providing that "[a]ny controversy or claim arising out of or relating to this contract or the breach thereof shall be settled by Arbitration."[2]

Another section of the franchise agreement provided that "[t]his Agreement shall be governed by and construed in accordance with the laws of the State of Connecticut." Pet. App. 15a. Just above the signature block, the agreement provided as follows: "Each of the parties hereto acknowledges that he has read and understands this Agreement and consents to be bound by all of its terms and conditions." Appendix to Brief

[1] During the events in question, DAI was a Connecticut corporation with its principal place of business in Connecticut. As a result of a merger in 1991, it is now a Florida corporation.

[2] The full text of the arbitration clause (Pet. App. 13a-14a) is as follows:

> Any controversy or claim arising out of or relating to this contract or the breach thereof shall be settled by Arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association at a hearing to be held in Bridgeport, Connecticut and judgment upon an award rendered by the Arbitrator(s) may be entered in any court having jurisdiction thereof. The commencement of arbitration proceedings by an aggrieved party to settle disputes arising out of or relating to this contract is a condition precedent to the commencement of legal action by either party. The cost of such a proceeding will be borne equally by the parties.

for the Appellants, Exhibit 1 (attachment A), *Casarotto v. Lombardi*, 886 P.2d 931 (Mont. 1994).[3] The agreement was executed by DAI and Paul Casarotto.

C. Initial Proceedings Below

A dispute subsequently arose between the parties. Despite the agreement to arbitrate all disputes, however, Casarotto brought suit against DAI, Lombardi and others in the Montana Eighth Judicial District Court, Cascade County.[4] In the suit, he alleged that he had entered into the franchise agreement and had opened a store on the west side of Great Falls in reliance on false representations of DAI and Lombardi that he would have an exclusive right to open a store in a different part of town when that location became available. He also alleged that DAI and Lombardi had interfered with efforts to

[3] Respondent Paul Casarotto filed an affidavit in the Montana state district court, averring that "I read the agreement over before I signed it," although he goes on to state that "no one ever told or explained to me that the agreement contained an arbitration clause or that the agreement was to be interpreted according to the laws of the State of Connecticut." Appendix to Brief for the Appellants, Exhibit 2, ¶ 8, *Casarotto v. Lombardi*, 886 P.2d 931 (Mont. 1994). DAI also provided Casarotto a detailed franchise offering circular that contained the following notice on the first page as required by the Federal Trade Commission: "READ ALL OF YOUR CONTRACT CAREFULLY. BUYING FRANCHISE [sic] IS A COMPLICATED INVESTMENT. TAKE YOUR TIME TO DECIDE. IF POSSIBLE, SHOW YOUR CONTRACT AND THIS INFORMATION TO AN ADVISOR, SUCH AS A LAWYER OR AN ACCOUNTANT." *Id.*, Exhibit 3, at 1. The offering circular also stated that the franchise agreement contained a binding arbitration agreement. *Id.*, Exhibit 3, at 18a.

[4] The suit named Paul Casarotto and his wife, Pamela Casarotto, as plaintiffs. Paul and Pamela Casarotto asserted claims against defendants other than DAI and Lombardi with whom they did not have an arbitration agreement. Those claims were not the subject of the opinions and orders below. With respect to the claims asserted against DAI and against Lombardi as DAI's agent, only Paul Casarotto had entered into the franchise agreement with DAI, and it is clear from the complaint that only he, and not his wife, is asserting claims against DAI and Lombardi. However, the opinions below referred to the plaintiffs in the plural and treated both plaintiffs alike.

sell his store. He asserted state-law claims against DAI and Lombardi for tortious interference with business relations, breach of covenant of good faith and fair dealing, fraud, constructive fraud, negligent misrepresentation, deceit, and violations of the Montana Consumer Protection Act. Pet. App. 13a.

Citing the arbitration provisions in the franchise agreement, DAI and Lombardi moved in the state district court to dismiss or stay the judicial proceedings against them pending arbitration. DAI and Lombardi argued that Section 2 of the FAA required arbitration of the claims, that the FAA preempted any state law impeding enforcement of a contractual agreement to arbitrate, and that, in any event, Montana law was inapplicable to the parties' agreement because the agreement contained the parties' choice of Connecticut law. DAI also filed a Demand for Arbitration with the American Arbitration Association. Pet. App. 14a, 50a.

The Montana district court granted Petitioners' motion to stay the lawsuit as against them pending arbitration. The court found that the parties' franchise agreement involved interstate commerce within the meaning of Section 2, that the claims asserted against DAI and Lombardi were encompassed by the agreement's arbitration clause, and that DAI had properly demanded arbitration of those claims. The court ordered that the claims against DAI and Lombardi "are hereby stayed until the arbitration has been had in accordance with the terms of the arbitration agreement." Pet. App. 49a-50a.

The Montana Supreme Court, sitting en banc (Pet. App. 47a), reversed the district court in a 4-3 decision in December 1994. Although the court did not dispute that the arbitration agreement met the requirements of federal law,[5] it nonetheless refused to enforce the agreement on the ground that it did not

[5] The Montana Supreme Court's opinion did not disturb the trial court's rulings that the parties' agreement to arbitrate involved interstate commerce, that the claims against DAI and Lombardi were encompassed by the agreement, and that DAI had filed a demand for arbitration.

comply with particular state notice requirements applicable only to arbitration agreements. *See* Mont. Code Ann. § 27-5-114(4) (1993). Pet. App. 27a. That statute provides that a contract must contain a notice that it is subject to arbitration in underlined capital letters on the first page of the contract, otherwise "the contract may not be subject to arbitration." The statute, by its terms and as interpreted by the Montana Supreme Court (Pet. App. 19a-20a, 51a), affects the enforceability of arbitration agreements but not other types of contracts.

The decision of the Montana Supreme Court not to enforce the parties' agreement to arbitrate proceeded in several steps. First, before reaching the question of whether the FAA preempts state arbitration laws, the court determined that it would apply Montana, not Connecticut, law to the agreement in this case. Although the parties had explicitly provided in their contract that Connecticut law would govern the agreement, the Montana Supreme Court rejected that selection. Instead, it ruled that Montana's arbitration notice statute (which had no counterpart in Connecticut law) constituted a fundamental public policy that could not be thwarted by the parties' choice of a different state's law. According to the court, the public policy of requiring notice of a contractual arbitration clause reflected state legislative concerns that Montanans receive sufficient notice before agreeing to a dispute resolution procedure--namely, arbitration--that was potentially inconvenient, expensive and devoid of the procedural safeguards of a judicial proceeding. Pet. App. 19a-20a.

Having decided to apply Montana law to the parties' agreement to arbitrate, the Montana Supreme Court next considered whether Montana's arbitration notice statute was preempted by the FAA. The court acknowledged decisions of this Court holding that Section 2 of the FAA created federal substantive law binding on the states on the issue of the enforceability of arbitration agreements. Pet. App. 20a-22a. The Montana Supreme Court nevertheless interpreted this Court's decision in *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University*, 489 U.S. 468

(1989), as retreating from earlier decisions by allowing courts to apply state arbitration laws so long as such laws do not "undermine the goals and policies of the FAA." Pet. App. 23a-25a. The Montana court then concluded that a notice statute ensuring that parties had "knowingly" entered into an arbitration agreement was consistent with the policies underlying the FAA as construed in *Volt*. Pet. App. 26a-27a.[6]

In deciding that Montana's arbitration notice statute was not preempted by Section 2 of the FAA, the Montana Supreme Court declined to follow contrary decisions from three federal courts of appeals and from the Missouri Supreme Court, all of which held that state arbitration notice requirements are preempted by the FAA. The court found those decisions unpersuasive because they either preceded *Volt* or contained little or no reference to *Volt*. The court found more persuasive decisions by intermediate state courts in Indiana and Texas that cited *Volt* in ruling that notice provisions in state arbitration acts are not preempted by the FAA. Pet. App. 26a.[7]

D. Subsequent Proceedings Below

This Court then vacated the judgment of the Montana Supreme Court and remanded for further consideration in light of *Terminix*, which had been decided after the Montana court rendered its decision in this case. *Doctor's Associates, Inc. v. Casarotto*, 115 S. Ct. 2552 (1995). The Montana Supreme

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[6] The court stated that it was of no significance that *Volt* had upheld a court's application of California law to an arbitration agreement where the parties had expressly chosen to abide by California law, whereas in this case the court was applying Montana law despite the parties' choice to be bound by Connecticut law. Pet. App. 25a.

[7] The author of the court's opinion also wrote separately to express his "personal observation" that federal appellate judges had misinterpreted the FAA and thus had unnecessarily and inappropriately deprived individuals of access to a system of justice available only in the courts. Pet. App. 28a-32a. Three of the seven Justices on the Montana Supreme Court dissented from the court's opinion. Pet. App. 33a-46a.

Court ignored Petitioners' request to brief and argue the issues on remand, Pet. App. 9a (Gray, J., dissenting), and, on August 31, 1995, reaffirmed and reinstated its December 1994 opinion.

In its decision on remand, the court first summarized its prior opinion, emphasizing again that its decision was based on an analysis of *Volt* that preemption is determined by whether the notice statute undermines the goals and policies of the FAA. Pet. App. 4a. Observing that this case did not involve a "state law which made arbitration agreements invalid and unenforceable," and further noting that the parties' agreement indisputably involved interstate commerce, the court concluded that "we can find nothing in the [*Terminix*] decision which relates to the issues presented to this Court in this case." Pet. App. 6a. In particular, the court saw nothing in *Terminix* that required it to modify its analysis of *Volt* "that state law is only preempted to the extent that it 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.'" Pet. App. 6a (quoting *Volt*, 489 U.S. at 477).

Three of the court's seven Justices dissented on the basis of the majority's "arrogant and cavalier approach to this important case on remand from the United States Supreme Court," and on the basis of the majority's misreading of *Volt* and *Terminix*'s reaffirmation of the supremacy of the FAA on the issue of enforceability of agreements to arbitrate. Pet. App. 9a-10a. Commenting on the majority's rush to decision without benefit of briefs or argument, the dissent concluded that "one must assume that the Court is simply unwilling to consider any analysis that would require a change in the result it remains determined to reach." Pet. App. 9a.

REASONS FOR GRANTING THE WRIT

This case presents an important issue regarding the scope of Section 2 of the Federal Arbitration Act, 9 U.S.C. § 2. Although that section provides that written arbitration agreements are "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any

contract," the Montana Supreme Court refused to enforce the agreement here because it did not comply with a state statute requiring that notice of an agreement to arbitrate (but no other contractual term) be typed in underlined capital letters on the first page of a contract.

This decision merits review for several reasons. To begin with, it is at odds with the language of Section 2 and with the clear teachings of *Terminix* and numerous other decisions of this Court construing that language. Section 2 plainly states that written arbitration agreements involving interstate commerce are to be enforced "save upon such grounds as exist . . . for the revocation of *any* contract." 9 U.S.C. § 2 (emphasis added). This Court has repeatedly read that language--most recently in *Terminix* --to mean that state laws that condition enforcement of arbitration agreements on compliance with particular state requirements are preempted unless they apply to enforcement of contract provisions generally, and not just to arbitration provisions. *See Terminix*, 115 S. Ct. at 838-39, 843; *Perry v. Thomas*, 482 U.S. 483, 489-91 & 492 n.9 (1987); *Southland Corp. v. Keating*, 465 U.S. 1, 10-16 (1984); *Moses H. Cone Memorial Hosp. v. Mercury Constr. Co.*, 460 U.S. 1, 24 (1983). Contrary to the reasoning of the Montana Supreme Court, nothing in *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University*, 489 U.S. 468 (1989), permits state courts to override the wishes of the contracting parties and impose obstacles to enforcement of arbitration agreements that are inapplicable to other types of agreements. *See, e.g., Mastrobuono v. Shearson Lehman Hutton, Inc.*, 115 S. Ct. 1212, 1215-16 (1995); *Terminix*, 115 S. Ct. at 843.

The decision below is also in direct conflict with the decisions of a number of federal courts of appeals, as well as that of another state supreme court. Unlike the court below, those courts followed the language of Section 2 and the decisions of this Court construing that language to hold that Section 2 preempts state laws conditioning enforcement of arbitration agreements on compliance with notice requirements that do not apply to contracts generally. *David L. Threlkeld & Co. v.*

Metallgesellschaft Ltd. (London), 923 F.2d 245, 249-50 (2d Cir.), *cert. dismissed*, 501 U.S. 1267 (1991); *Securities Indus. Ass'n v. Connolly*, 883 F.2d 1114, 1120 (1st Cir. 1989), *cert. denied*, 495 U.S. 956 (1990); *Webb v. R. Rowland & Co.*, 800 F.2d 803, 806-07 (8th Cir. 1986); *Collins Radio Co. v. Ex-Cell-O Corp.*, 467 F.2d 995, 997-99 (8th Cir. 1972); *Bunge Corp. v. Perryville Feed & Produce, Inc.*, 685 S.W.2d 837, 839 (Mo. 1985) (en banc).

Finally, the issues presented here have importance beyond this case. Eight states in addition to Montana have enacted arbitration laws with notice requirements comparable to Montana's or other laws intended to direct particular attention to an arbitration provision in a contract. *See* Part III, *infra*. More generally, numerous states have placed conditions on agreements to arbitrate that do not apply to other contracts. *Id.* Taken collectively, these state laws stand as a direct impediment to the national uniformity contemplated by Section 2, leaving persons transacting business in multiple states subject to the vagaries of inconsistent state arbitration laws. Review by this Court is thus necessary to implement Congress's "inten[t] to foreclose state legislative attempts to undercut the enforceability of arbitration agreements." *Southland*, 465 U.S. at 16.

I. THE FEDERAL ARBITRATION ACT PREEMPTS MONTANA'S STATUTORY RESTRICTIONS ON ENFORCEMENT OF ARBITRATION AGREEMENTS.

The question presented by this petition is straightforward. May Montana refuse to enforce an otherwise valid agreement to arbitrate on the ground that the agreement does not comply with notice requirements applicable to arbitration agreements but not to other types of agreements? The language of Section 2, and this Court's consistent construction of that language, make clear that Montana may not. Section 2 expressly preempts the application of Montana's arbitration notice statute, Mont. Code Ann. § 27-5-114(4) (1993), to agreements involving interstate commerce.

A. The language of Section 2 is plain and unequivocal. With respect to contracts within its ambit--as the contract here, involving an interstate transaction, concededly is--it declares written agreements to arbitrate to be "valid, irrevocable, and enforceable" as a matter of federal law. 9 U.S.C. § 2. To that principle, Section 2 then provides an explicit, and explicitly limited, exception: agreements to arbitrate may be deemed unenforceable "upon such grounds as exist at law or in equity for the revocation of *any* contract." *Id.* (emphasis added). As a matter of plain language, therefore, Section 2 permits courts to apply state laws applicable to contracts generally, but not state laws singling out arbitration agreements for disfavored treatment.

This reading of Section 2 is confirmed by numerous decisions of this Court. As the Court has repeatedly recognized, Section 2 embodies a "liberal federal policy favoring arbitration agreements." *Moses H. Cone*, 460 U.S. at 24. Its "basic purpose . . . is to overcome courts' refusals to enforce agreements to arbitrate." *Terminix*, 115 S. Ct. at 838; *accord Mastrobuono*, 115 S. Ct. at 1215. By enacting the FAA, Congress "intended courts . . . to 'place such agreements upon the same footing as other contracts.'" *Terminix* at 838 (quoting *Volt*, 489 U.S. at 474) (internal quotation marks omitted). It thus "withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration." *Southland*, 465 U.S. at 10; *accord Mastrobuono* at 1216.

The Court has acknowledged only two limitations on the enforceability of arbitration agreements governed by the FAA: "they must be part of a written maritime contract or a contract 'evidencing a transaction involving commerce' and such clauses may be revoked upon 'grounds as exist at law or in equity for the revocation of any contract.'" *Southland*, 465 U.S. at 10-11. The Court has emphasized that it "see[s] nothing in the Act indicating that the broad principle of enforceability [in Section 2] is subject to *any* additional limitations under state law." *Id.* at 11 (emphasis added). As a result, the Court has said that, once the nexus with interstate commerce

is established, state law may be applied to invalidate an arbitration agreement only if the law "arose to govern issues concerning the validity, revocability, and enforceability of contracts generally." *Perry*, 482 U.S. at 493 n.9; *accord Terminix*, 115 S. Ct. at 843. By contrast, "[a] state-law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue does not comport with this requirement of § 2. A court may not, then, in assessing the rights of litigants to enforce an arbitration agreement, . . . rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding" denying enforcement of the agreement. *Perry*, 482 U.S. at 493 n.9 (citations omitted); *accord Southland*, 465 U.S. at 16-17 n.11.

The Montana Supreme Court refused to acknowledge these principles, despite their reaffirmance last Term in *Terminix*. It is true, as the Montana court noted, that much of the opinion in *Terminix* is devoted to construing the interstate commerce language of Section 2, an issue that is not presented in this case. And it is also true that the Alabama statute at issue in *Terminix* invalidated all arbitration agreements, not just those for which no special notice was given. But the importance of *Terminix* extends beyond its precise holding, for it makes clear again that Section 2 preempts state laws--like Alabama's and Montana's--that single out arbitration agreements from other types of agreements for unfavorable treatment. As the Court stated in describing the scope of Section 2, "States may not . . . decide that a contract is fair enough to enforce all its basic terms (price, service, credit), but not fair enough to enforce its arbitration clause." *Terminix*, 115 S. Ct. at 843. And in language that directly controls the disposition of this case, the Court emphasized that "*[t]he Act makes any such state policy unlawful*, for that kind of policy would place arbitration clauses on an unequal 'footing,' directly contrary to the Act's language and Congress's intent." *Id.* (emphasis added).[8]

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[8] Justice O'Connor, in her concurrence, indicated that the effect of the decision in *Terminix* would be to preempt statutes like that upheld by the court below:

(Footnote continued)

The court below paid no heed to these statements, however. Rather, the court held that Montana could do precisely what the FAA prohibits. By its terms, Montana arbitration law makes unenforceable any agreement to arbitrate that is not accompanied by the prescribed notice.[9] The statute does not affect the validity of contracts generally under Montana law; it limits only the enforcement of arbitration agreements as part of a state policy disfavoring arbitration. Indeed, as the Montana Supreme Court candidly acknowledged, the notice statute reflects legislative concern about Montana citizens "entering into an agreement . . . to a procedure as potentially inconvenient, expensive, and devoid of procedural safeguards as the one provided for by the rules of the American Arbitration Association." Pet. App. 20a.[10] This Court noted in

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The reading of § 2 adopted today will displace many state statutes carefully calibrated to protect consumers, see, *e.g.*, Mont. Code Ann. § 27-5-114(2)(b) (1993) (refusing to enforce arbitration clauses in consumer contracts where the consideration is $5,000 or less), and state procedural requirements aimed at ensuring knowing and voluntary consent, see, *e.g.*, S.C. Code Ann. § 15-48-10(a) (Supp. 1993) (*requiring that notice of arbitration provision be prominently placed on first page of contract*).

115 S. Ct. at 843 (emphasis added).

[9] The notice statute, Mont. Code Ann. § 27-5-114(4) (1993), is part of the Montana Uniform Arbitration Act. However, it is a deviation from the Uniform Arbitration Act (1955), 7 U.L.A. 1 (West 1985 & Supp. 1995), which contains no notice requirement. Montana has enacted other provisions refusing to enforce arbitration in certain types of contracts (Pet. App. 51a), which also are deviations from the uniform act. Montana enacted its arbitration act in 1985 in the wake of the Court's decision in *Southland* that states cannot altogether ban arbitration agreements that are otherwise enforceable under Section 2 of the FAA.

[10] This same anti-arbitration policy caused the Montana Supreme Court to make a second, related error: its decision to apply Montana law despite the parties' explicit contractual choice of Connecticut law. The Montana Supreme Court relied on a state policy hostile to arbitration as the reason for applying Montana law to the agreement under conflict-of-laws principles and then proceeding to invalidate the agreement under that same policy. If it were not for the arbitration notice requirement that Petitioners argue is preempted by Section 2, the court below would not have reached

(Footnote continued)

Terminix that it is precisely that type of focused hostility toward arbitration that Congress sought to overcome when it enacted the FAA. 115 S. Ct. at 838.[11]

B. The Montana Supreme Court, in its initial opinion, appeared to concede that the decisions in *Southland* and *Perry*, standing alone, would require enforcement of the arbitration agreement in this case. Pet. App. 20a-23a. The court found its way around *Southland* and *Perry*, however, by holding that *Volt* had limited preemption of state law only to those instances in which enforcement of state law would "undermine the goals and policies of the FAA." Pet. App. 25a; *see also* Pet. App. 4a. But *Volt* did no such thing. The Court in *Volt* had no occasion even to consider the preemptive force of Section 2 with regard to the *enforcement* of arbitration agreements, since the California law chosen by the parties in *Volt* did not render their arbitration agreement unenforceable. As this Court recently explained, *see Mastrobuono*, 115 S. Ct. at 1216, *Volt* held only that the FAA requires courts "to enforce privately negotiated agreements to arbitrate, like other contracts, in accordance with their terms." *Volt*, 489 U.S. at 478. In other words, the "FAA's pro-arbitration policy does not operate without regard to the wishes of the contracting parties." *Mastrobuono* at 1216; *see Volt* at 478.

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its conclusion that the Connecticut law chosen by the parties (which has no special notice requirement) was offensive to Montana's public policy. Pet. App. 19a-20a. In any event, because the Montana statute is preempted by Section 2, it is not necessary for this Court to reach out and decide whether Montana's conflict-of-laws analysis was independently flawed by its dependence on a statute evidencing hostility toward arbitration.

[11] As this Court has noted, Congress did not disable the states from applying general principles against unconscionable agreements or unequal bargaining power. *Terminix*, 115 S. Ct. at 843. But a state may not *single out* arbitration agreements for special treatment out of a concern that those agreements in particular may be the product of unequal bargaining power. *Id.*; *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 33 (1991); *Perry*, 482 U.S. at 493 n.9; *Saturn Distribution Corp. v. Williams*, 905 F.2d 719, 726 (4th Cir.), *cert. denied*, 498 U.S. 983 (1990).

The situation here, of course, is just the opposite of that presented in *Volt*. Unlike *Volt*, where the state court applied the law chosen by the parties to the contract, the court here *refused* to apply the law chosen by the parties, stating that it was contrary to Montana public policy as expressed in the arbitration notice statute. Pet. App. 20a. Moreover, this Court noted in *Volt* that the state law at issue *fostered* the federal policy favoring arbitration, by resolving a practical problem arising in multiparty disputes that the FAA failed to address. *Volt*, 489 U.S. at 476 n.5. The Court reached the question of whether the state procedure "would undermine the goals and policies of the FAA" only because the FAA had not "displaced state regulation in [that] area." *Id.* at 477-78. But, while the FAA might be silent about the procedural situation presented in *Volt*, it speaks in the clearest possible terms to the circumstances under which an agreement to arbitrate must be enforced. *Southland*, 465 U.S. at 10-11. [12]

Nothing in *Volt* itself, therefore, detracts from the holdings in *Southland* and *Perry* that Section 2, by its plain language, expressly preempts state laws conditioning enforcement of arbitration agreements on compliance with requirements not applicable to *any* contract. And that reading of *Volt* is confirmed by *Terminix*. *See* 115 S. Ct. at 838-39, 843. While the Montana Supreme Court saw nothing in *Terminix* to affect its

[12] It is true, as the Montana Supreme Court observed, that the FAA does not "occupy the entire field of arbitration." *Volt*, 489 U.S. at 477. *Volt*, for example, dealt with an aspect of arbitration procedure not addressed by the FAA. *Id.* at 476 n.5. But under Section 2 of the FAA, the parties may be assured that their agreement to arbitrate will be enforced so long as the agreement is "[a] written provision in . . . a contract evidencing a transaction involving commerce" that is not revocable "upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2; *see Southland*, 465 U.S. at 10-11. Any state law that imposes additional obstacles to enforcement of arbitration agreements is preempted under the Supremacy Clause. *Terminix*, 115 S. Ct. at 838-39, 843; *Perry*, 482 U.S. at 493 n.9; *see also Mastrobuono*, 115 S. Ct. at 1216 (FAA ensures enforcement of agreement to arbitrate punitive damages claims "even if a rule of state law would otherwise exclude such claims from arbitration").

reliance on *Volt* to justify the balancing test that it derived from that decision, this Court in *Terminix* made quite clear that state laws that place arbitration agreements "on an unequal footing" *by definition* undermine the goals of the FAA. *Id.* at 839. Even after *Volt*, therefore, Section 2 must still be read to preempt state laws, like the Montana law, that make an arbitration agreement unenforceable even though another type of agreement would be held valid.

We think, therefore, that the Montana Supreme Court was simply mistaken in refusing to apply to this case the principles reaffirmed in *Terminix*. If that view is correct, then the case might be considered one appropriate for summary reversal. In any event, as we discuss below, the decision of the Montana Supreme Court is contrary to the holdings of several federal and state courts, and the issue itself is of considerable legal and practical importance. Therefore, this Court should, at a minimum, grant plenary review to clarify the power of the states to apply arbitration-specific laws to invalidate arbitration agreements.

II. THE DECISION OF THE MONTANA SUPREME COURT IS IN DIRECT CONFLICT WITH DECISIONS OF THE FIRST, SECOND AND EIGHTH CIRCUITS AND THE HIGHEST COURT OF MISSOURI.

The decision below also directly conflicts with decisions by three federal courts of appeals and the Supreme Court of Missouri. Each of those courts has held that Section 2 preempts state laws imposing notice requirements on agreements to arbitrate.

In *David L. Threlkeld & Co. v. Metallgesellschaft Ltd. (London)*, 923 F.2d 245, 249-50 (2d Cir.), *cert. dismissed*, 501 U.S. 1267 (1991), the Second Circuit held that the FAA preempted a Vermont statute, Vt. Stat. Ann. tit. 12, § 5652(b) (Supp. 1994), prohibiting enforcement of an agreement to arbitrate unless it was accompanied by a prominently

displayed, signed acknowledgment of arbitration in a form prescribed by the statute.[13] Although the court agreed that the form contract in that case did not comply with the "rigorous standard" for arbitration agreements set forth in the Vermont statute, the court held that the statute was preempted by federal law and ordered the parties to arbitrate their dispute. *Id.* at 249. The court found that the FAA required only that an agreement to arbitrate be in writing, a "standard obviously . . . less rigid than that required by the Vermont statute." *Id.* at 250.[14] Because the Vermont statute "directly clash[ed]" with the FAA, and because it "effectively reincarnate[d] the former judicial hostility towards arbitration," the court held that it was preempted and that the arbitration agreement was enforceable. *Id.*

In *Threlkeld*, 923 F.2d at 250, the Second Circuit expressed its agreement with a similar decision by the First Circuit in *Securities Industry Ass'n v. Connolly*, 883 F.2d 1114, 1120 (1st Cir. 1989), *cert. denied*, 495 U.S. 956 (1990). In *Connolly*, the court invalidated Massachusetts regulations that required securities broker-dealers to "fully disclos[e] to the customer in writing the legal effect" of an arbitration clause in a customer account agreement. *Id.* at 1125. The First Circuit ruled that "[t]he FAA prohibits a state from taking more

[13] In that case, the parties had signed the defendant's standard-form customer contract that incorporated by reference the rules of a commodities exchange. Those rules, in turn, provided that any dispute arising out of any contract shall be referred to arbitration in accordance with the rules.

[14] The applicable substantive provision of the FAA in *Threlkeld* was Section 202 of the FAA, 9 U.S.C. § 202, rather than Section 2, because the arbitration agreement involved international commerce. *See Threlkeld*, 923 F.2d at 248, 250. Section 202 and Section 2 are similar in that both require a written agreement involving international or interstate commerce to create an enforceable agreement to arbitrate. While Section 2 also requires that the agreement not be revocable upon such grounds as exist for the revocation of any contract, that "savings" clause is not at issue in this case, as the Montana Supreme Court did not (and, obviously, could not), rely on that clause of Section 2 in applying Montana's arbitration-specific notice requirements. *See* Pet. App. 24a-27a.

stringent action addressed specifically, and limited, to arbitration contracts. *Id.* at 1120. Finding that the regulations "derive their essential meaning from the fact that a contract to arbitrate is at issue," the court held that the regulations were in conflict with the FAA and were therefore preempted. *Id.* at 1123.[15]

The First Circuit acknowledged that Massachusetts might have an interest in providing for greater disclosures between broker-dealers and their customers and for better protection of consumers. The court observed that states are free to act to preserve the integrity of the securities business, but not in ways that treat arbitration agreements more harshly than other standard-form consumer contracts. *Id.* at 1124. Although a state may prefer to hold arbitration agreements to stricter standards, the First Circuit, relying on Section 2, concluded that "[t]hat value judgment was within the congressional domain--and only Congress, not the states, may create exceptions to it." *Id.*; *cf. Terminix*, 115 S. Ct. at 843 (O'Connor J., concurring) (concluding that the Court's decision will displace state arbitration laws intended to protect consumers, including South Carolina's law (like Montana's) that requires notice of arbitration to be prominently placed on first page of contract).

The First Circuit in *Connolly* noted the similarity of the Massachusetts regulations to state statutes that the Eighth Circuit had previously held preempted by the FAA. *See Connolly*, 883 F.2d at 1120. In *Webb v. R. Rowland & Co.*, 800 F.2d 803 (8th Cir. 1986), the Eighth Circuit enforced the arbitration provisions in a securities broker's customer contract even though the contract--which specified that Missouri law applied--did not contain a notice of the arbitration provisions

[15] The author of the Montana Supreme Court's opinions in this case wrote a separate concurrence to the court's initial opinion that harshly criticized the First Circuit's decision in *Connolly*, taking the First Circuit to task for failing to consider "the total lack of procedural safeguards in the arbitration process" and the use of arbitration provisions by national companies to "subvert our system of justice." Pet. App. 30a-32a.

in ten-point capital letters above the signature block, as required by Missouri law, Mo. Rev. Stat. § 435.460 (1994). The court cited *Southland*, 465 U.S. at 10-11, for the principle that Section 2 of the FAA provides the only limitations on the enforceability of an arbitration agreement covered by the Act. Thus, the court held that the Missouri notice statute could not be applied to bar enforcement of the arbitration agreement in the case before it. *Webb*, 800 F.2d at 806-07.[16]

Finally, the Missouri Supreme Court itself has refused to apply the Missouri statute at issue in *Webb* to invalidate an arbitration agreement involving interstate commerce. *Bunge Corp. v. Perryville Feed & Produce, Inc.*, 685 S.W.2d 837 (Mo. 1985) (en banc). The court held that it could not apply the statute to an arbitration agreement within the coverage of the FAA without violating the Supremacy Clause, because the statute "seeks to impose a requirement for contracts to arbitrate which is in addition to the requirements of the Federal Arbitration Act. All that is apparently required under that act is contractual language and format sufficient for an ordinarily written contract." *Id.* at 839 (citation omitted).

These cases, taken together, create a body of law that is in irreconcilable conflict with the decision of the Montana Supreme Court.[17] While the Montana Supreme Court thought

[16] In *Collins Radio Co. v. Ex-Cell-O Corp.*, 467 F.2d 995 (8th Cir. 1972), the Eighth Circuit also construed Section 2 of the FAA as "plainly void[ing] all [state] doctrines of invalidity, unenforceability and revocability which apply only to arbitration agreements." *Id.* at 998. The court therefore enforced an arbitration agreement that specified Texas law as governing, even though the agreement did not comply with a Texas arbitration law that required the signed acknowledgment of counsel to the contracting parties that the agreement to arbitrate was made upon the advice of counsel.

[17] The Montana arbitration notice statute is indistinguishable from the Vermont, Missouri and Texas statutes and Massachusetts regulations that the First, Second and Eighth Circuits and the Missouri Supreme Court have all found preempted by Section 2. Indeed, a federal court in Montana has held that the Montana notice statute is preempted by the FAA. *Snap-On Tools Corp. v. Vetter*, 838 F. Supp. 468, 472 (D. Mont. 1993).

that *Volt* had altered the preemptive scope of the federal act, both the Second Circuit and the First Circuit found preemption *after* the decision in *Volt*. The court in *Connolly*, in fact, expressly (and correctly) distinguished *Volt* on the ground that, unlike the Massachusetts regulations, the California regulations applied in *Volt* "did not impinge on the validity or enforceability of the arbitral contract." *Connolly*, 883 F.2d at 1119 n.3. The Montana Supreme Court has thus embraced an interpretation of the FAA based on *Volt* that is squarely rejected by the First Circuit.[18] The clear and direct conflict between the decision of the Montana Supreme Court and the decisions of federal courts of appeals and the Missouri Supreme Court therefore warrants this Court's review.[19]

[18] In *Saturn Distribution Corp. v. Williams*, 905 F.2d 719, 723-27 (4th Cir.), *cert. denied*, 498 U.S. 983 (1990), the Fourth Circuit considered and rejected the same argument accepted by the Montana Supreme Court: "the notion . . . that the [state] statute may be harmonized with the FAA because it only ensures 'consensual rather than forced arbitration.'" *Id.* at 726 (quoting *Saturn Distribution Corp. v. Williams*, 717 F. Supp. 1147, 1151 (E.D. Va. 1989)). The Fourth Circuit concluded that *Volt* "is not to the contrary." *Id.* While the Virginia statute preempted in *Saturn* imposed restrictions on arbitration different from the notice requirements at issue in this case, the Fourth Circuit's reliance on *Webb* and *Connolly*, *see Saturn*, 905 F.2d at 723-24, strongly indicates that the Fourth Circuit would differ with the Montana Supreme Court on the preemption question presented here.

[19] The Montana Supreme Court recognized that its decision was in conflict with the decisions cited above, but chose instead to follow the lead of two state intermediate appellate courts that had read *Volt* as authority to invalidate arbitration agreements that did not comply with state arbitration notice statutes. Pet. App. 26a; *see American Physicians Service Group Inc. v. Port Lavaca Clinic Associates*, 843 S.W.2d 675, 678 (Tex. Ct. App. 1992) (en banc) ("Texas Act prevails over the FAA"), *writ of error denied* (Tex. Apr. 21, 1993); *Albright v. Edward D. Jones & Co.*, 571 N.E.2d 1329, 1332-33 (Ind. Ct. App. 1991), *transfer denied* (Ind. Feb. 27, 1992), *cert. denied*, 113 S. Ct. 61 (1992). The decision by the Indiana Court of Appeals, although erroneous in its failure to find preemption, was inappropriate for review by this Court because the state court's judgment was ultimately based on the independent state ground that the arbitration agreement did not encompass the plaintiff's claims. *See Albright*, 571 N.E.2d at 1333-34.

III. THE MONTANA SUPREME COURT'S DECISION RAISES ISSUES OF NATIONAL IMPORTANCE.

The decision below, if left standing, would seriously disrupt the national uniformity that Congress sought to achieve by putting arbitration agreements on the same footing as other contracts. Arbitration agreements like the one in this case have become a common feature in business and consumer relationships. Financial institutions, franchisors, manufacturers, and a multitude of other companies conducting interstate businesses now include arbitration agreements in their contracts. *See generally* Henry C. Strickland, *The Federal Arbitration Act's Interstate Commerce Requirement: What's Left for State Arbitration Law?*, 21 Hofstra L. Rev. 385, 429-54 (1992). As the case law indicates, national and international economies have come to rely on arbitration in a variety of circumstances. *See, e.g.*, *Threlkeld*, 923 F.2d at 246-47 (contract between member of foreign commodities exchange and American trader); *Connolly*, 883 F.2d at 1116 (customer agreement with securities broker); *Webb*, 800 F.2d at 804-05 (same); *Collins*, 467 F.2d at 996 (purchase agreement between manufacturer and its supplier of computer parts); *Bunge*, 685 S.W.2d at 838 (commercial contract for bulk purchase of soybeans).

It is thus of particular importance that parties to arbitration agreements be assured that their arbitration agreements are enforceable regardless of whether a particular state is receptive to, or hostile to, arbitration. The decisions of the First, Second and Eighth Circuits and the Missouri Supreme Court, by preempting state arbitration notice requirements, affirmed the validity of standardized arbitration provisions that have flourished as a chosen means of resolving disputes. As this Court has found, Congress sought to confer the advantages of arbitration on consumers and businesses alike, *Terminix*, 115 S. Ct. at 842-43, by providing for "rapid and unobstructed enforcement of arbitration agreements." *Moses H. Cone*, 460 U.S. at 23. But the Montana Supreme Court's decision, along with those of the Texas and Indiana intermediate appellate

courts (see note 19 *supra*), creates new uncertainty in the law that undermines Congress's support of arbitration as an alternative device for dispute resolution.

The rule of law announced by the Montana Supreme Court does not take into account the varying, even conflicting, arbitration laws that exist from state to state and their impact on interstate commerce. State arbitration notice provisions are far from uniform. Montana and three other states impose varying notice requirements for contracts subject to an agreement to arbitrate.[20] An additional five states have enacted differing laws regulating the placement and acknowledgment of arbitration agreements within certain kinds of contracts.[21] Furthermore, numerous states have placed other conditions on agreements to arbitrate that do not apply to contracts generally. Montana, for example, refuses to enforce arbitration

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[20] Mo. Rev. Stat. § 435.460 (1994) (notice that contract contains arbitration agreement must be placed adjacent to signature block in ten-point capital letters); S.C. Code Ann. § 15-48-10(a) (Law. Co-op. Supp. 1993) (notice that contract is subject to arbitration shall be typed in underlined capital letters or rubber-stamped prominently on first page of contract); Vt. Stat. Ann. tit. 12, § 5652(b) (Supp. 1994) (parties must sign written acknowledgment of arbitration that contains language provided in statute and that is prominently displayed in contract).

[21] Ga. Code Ann. § 9-9-2(c)(8), (9) (Michie Supp. 1994) (arbitration provisions in residential real estate contracts and employment contracts must be separately initialed at the time of contract's execution); Iowa Code § 679A.1(2)(c) (1995) (agreement to arbitrate tort claims must be in separate writing executed by parties); R.I. Gen. Laws § 10-3-2 (Supp. 1994) (arbitration provisions in insurance contracts must be placed immediately above parties' signatures); Tenn. Code Ann. § 29-5-302(a) (Supp. 1994) (arbitration clause in contracts relating to farm or residential property must be separately signed or initialed by parties); Tex. Rev. Civ. Stat. Ann. art. 224(b) (West Supp. 1994) (excluding from arbitration act any contract by an individual person for acquisition of property or services where consideration is $50,000 or less unless parties agree in writing to submit to arbitration and such agreement is signed by parties and their attorneys); Tex. Rev. Civ. Stat. Ann. art. 224(c) (West Supp. 1994) (personal injury claims excluded from scope of arbitration act except upon advice of counsel to both parties as evidenced by written agreement signed by counsel to both parties).

agreements in certain types of contracts where the consideration is $5,000 or less. Mont. Code Ann. § 27-5-114(2)(b) (1993), *cited in Terminix*, 115 S. Ct. at 843 (O'Connor, J., concurring). Pet. App. 51a.[22]

The results of Montana's interpretation of the FAA are evident in this case. The Montana Supreme Court, applying its conflict-of-laws principles, rejected the parties' choice of Connecticut law and instead applied the Montana arbitration act.[23] The parties therefore lost the benefit of their agreement to arbitrate because they failed to comply with a state notice statute that they did not anticipate would ever be applied to their agreement. A company doing business nationally cannot know in what state it might be sued and--after the decision below--which state's arbitration notice statute might apply. Although Section 2 of the FAA does subject parties to state laws relating to contracts generally, Congress sought by enacting the FAA to remove special state-imposed obstacles to the parties' attempts to arbitrate their disputes because such differential state law treatment of arbitration provisions would undermine the "declared . . . national policy favoring arbitration." *Southland*, 465 U.S. at 10.

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[22] A state-law exclusion from arbitration for small transactions would exclude a significant percentage of disputes that are now subject to arbitration. "[A]ccording to the American Arbitration Association . . ., more than one-third of its claims involve amounts below $10,000 . . . ." *Terminix*, 115 S. Ct. at 843. Georgia similarly excludes from enforcement under its arbitration act any agreement to arbitrate relating to insurance contracts, loan agreements and consumer financing agreements involving $25,000 or less, as well as all contracts involving consumer transactions. Ga. Code Ann. § 9-9-2(c) (Michie Supp. 1994). Similar limitations on the enforceability of arbitration agreements can be found in many states' laws. *See* Strickland, *supra*, at 402 n.98 (citing statutes from 13 different states); *see also Mastrobuono*, 115 S. Ct. at 1215 (New York law barring awards of punitive damages in arbitration).

[23] Connecticut law is virtually identical to the FAA in the conditions it imposes for enforcing agreements to arbitrate. *See* Conn. Gen. Stat. § 52-408 (1995).

The problems encountered by Petitioners in this case in enforcing their agreement to arbitrate will be exacerbated if other states now adopt Montana's interpretation of the preemptive scope of the FAA.[24] A state such as Alabama that has expressed its hostility toward arbitration by banning enforcement of arbitration agreements, *see Terminix*, 115 S. Ct. at 837, could now express that hostility by enacting new laws imposing specific conditions on enforcing arbitration agreements. In the past, this Court has rejected interpretations of the FAA that "would permit states to override the declared policy requiring enforcement of arbitration agreements." *Southland*, 465 U.S. at 17 n.11. The decision of the Montana Supreme Court resurrects the obstacles that this Court has held were eradicated when Congress enacted legislation making arbitration agreements "valid, irrevocable, and enforceable" as a matter of federal law. 9 U.S.C. § 2.

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[24] Other state courts have applied their state's arbitration notice statute to the case before them, but those decisions made no mention of the FAA or preemption, presumably because no party contended that the arbitration agreement involved interstate commerce. *E.g.*, *Hefele v. Catanzaro*, 727 S.W.2d 475 (Mo. Ct. App. 1987); *A.C. Beals Co. v. Rhode Island Hosp.*, 292 A.2d 865 (R.I. 1972); *Joder Bldg. Corp. v. Lewis*, 569 A.2d 471 (Vt. 1989). At the same time, some state courts have found their own state's notice statutes preempted by the FAA. *E.g.*, *McCarney v. Nearing, Staats, Prelogar & Jones*, 866 S.W.2d 881, 887-88 (Mo. Ct. App. 1993), *transfer denied* (Mo. Jan. 25, 1994); *Woermann Constr. Co. v. Southwestern Bell Tel. Co.*, 846 S.W.2d 790, 792-93 (Mo. Ct. App. 1993); *Godwin v. Stanley Smith & Sons*, 386 S.E.2d 464, 467 (S.C. Ct. App. 1989).

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

MARK R. KRAVITZ *
JEFFREY R. BABBIN
WIGGIN & DANA
One Century Tower
P.O. Box 1832
New Haven, CT 06508-1832
(203) 498-4400

H. BARTOW FARR, III
FARR & TARANTO
2445 M Street, N.W.
Washington, D.C. 20037
(202) 775-0184

* *Counsel of Record*

Dated: September 29, 1995

APPENDIX

APPENDIX A

[Filed August 31, 1995]

IN THE SUPREME COURT
OF THE STATE OF MONTANA
1995

No. 93-488

PAUL CASAROTTO and PAMELA CASAROTTO,

Plaintiffs and Appellants,

v.

NICK LOMBARDI and DOCTOR'S ASSOCIATES, INC.,

Defendants and Respondents,

and

DANIEL L. and DEB HUDSON, and D&D SUBWAY CORPORATION,

Defendants.

Appeal from District Court of the Eighth Judicial District,
In and for the County of Cascade,
The Honorable John M. McCarvel, Judge presiding

Submitted: August 22, 1995
Decided: August 31, 1995

Justice Terry N. Trieweiler delivered the opinion of the Court.

Plaintiffs Paul and Pamela Casarotto filed this suit in the District Court for the Eighth Judicial District in Cascade County to recover damages which they claim were caused by the defendants' breach of contract and tortious conduct. Defendants Nick Lombardi and Doctor's Associates, Inc., (DAI) moved the District Court for an order dismissing plaintiffs' complaint, or in the alternative, staying further judicial proceedings pending arbitration of plaintiffs' claims pursuant to a provision in DAI's franchise agreement with plaintiffs which required that disputes "arising out of or relating to" that contract be settled by arbitration. The District Court granted defendants' motion, and ordered that further judicial proceedings be stayed until arbitration proceedings were completed in accordance with the terms of the parties' agreement. Plaintiffs appealed from that order, and on December 15, 1994, we reversed the order of the District Court and remanded this case to that court for further proceedings. *Casarotto v. Lombardi* (1994), 268 Mont. 369, 886 P.2d 931. Following this Court's decision, the defendants petitioned the Supreme Court of the United States for a writ of certiorari. That petition was granted, and on June 12, 1995, the United States Supreme Court ordered that the December 15, 1994, judgment of this Court be vacated, and remanded this case to the Supreme Court of Montana for further consideration in light of that Court's decision in *Allied-Bruce Terminix Cos. v. Dobson* (1995), 513 U.S. ____, 115 S. Ct. 834, 130 L. Ed. 2d 753. Having further considered our prior decision in light of *Dobson*, we now reaffirm and reinstate our prior opinion.

FACTUAL BACKGROUND

Paul and Pamela Casarotto entered into a franchise agreement with DAI which allowed them to open a Subway Sandwich Shop in Great Falls, Montana. DAI's franchise agreement included on page nine a provision which required that controversies or claims related to the contract shall be settled by arbitration in Bridgeport, Connecticut. However, the franchise agreement did not include notice on the front page to the effect that the contract was subject to arbitration, as required by § 27-5-114(4), MCA.

The Casarottos filed this action in the District Court based on their allegations that DAI breached its agreement with them, defrauded them, and engaged in other tortious conduct, all of which resulted in loss of business and the resulting damage.

DAI moved to dismiss the Casarottos' claim or to stay further judicial proceedings pending arbitration pursuant to the arbitration provision in its franchise agreement. The District Court granted DAI's motion to stay further judicial proceedings pursuant to 9 U.S.C. § 3, which is part of the Federal Arbitration Act found at 9 U.S.C. §§ 1-15 (1988).

On appeal from the District Court's order, we considered whether Montana's notice requirement was preempted by the Federal Arbitration Act in light of the U.S. Supreme Court's recent decision in *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University* (1989), 489 U.S. 468, 109 S. Ct. 1248, 103 L. Ed. 2d 488. In that case, the Supreme Court stated that:

> The FAA contains no express pre-emptive provision, nor does it reflect a congressional intent to occupy the entire field of arbitration. But even when Congress has not completely displaced state regulation in an area, state law may nonetheless be preempted to the extent that it actually conflicts with federal law--that is, to the extent that it "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Hines v. Davidowitz*, 312 U.S. 52, 67, 61 S.Ct. 399, 404, 85 L.Ed.2d 581 (1941). *The question before us, therefore, is whether application of Cal.Civ.Proc. Code Ann. § 1281.2(c) to stay arbitration under this contract in interstate commerce, in accordance with the terms of the arbitration agreement itself, would undermine the goals and policies of the FAA. We conclude that it would not.*

Volt, 489 U.S. at 477-78, 109 S. Ct. at 1255 (citation omitted; emphasis added).

Based on the cited language from *Volt*, we concluded that the nature of our inquiry was whether Montana's notice requirement found at § 27-5-114(4), MCA, would "undermine the goals and policies of the FAA." We concluded that it does not. *Casarotto*, 886 P.2d at 931. We explained our conclusion as follows:

> Our conclusion that Montana's notice requirement does not undermine the policies of the FAA is based on the Supreme Court's conclusion that it was never Congress's intent when it enacted the FAA to preempt the entire field of arbitration, and its further conclusion that the FAA does not require parties to arbitrate when they have not agreed to do so. That Court held that the purpose of the FAA is simply to enforce arbitration agreements into which parties had entered, and acknowledged that the interpretation of contracts is ordinarily a question of state law. *Volt*, 489 U.S. at 474, 109 S.Ct. at 1253.
>
> Presumably, therefore, the Supreme Court would not find it a threat to the policies of the Federal Arbitration Act for a state to require that before arbitration agreements are enforceable, they be entered knowingly. To hold otherwise would be to infer that arbitration is so onerous as a means of dispute resolution that it can only be foisted upon the uninformed. That would be inconsistent with the conclusion that the parties to the contract are free to decide how their disputes should be resolved.
>
> Montana's notice requirement does not preclude parties from knowingly entering into arbitration agreements, nor do our courts decline to enforce arbitration agreements which are entered into knowingly.
>
> Therefore, we conclude that Montana's notice statute found at § 27-5-114(4), MCA, would not undermine the goals and policies of the FAA, and is not preempted by 9 U.S.C. § 2 (1988).

Casarotto, 886 P.2d at 938-39.

On January 18, 1995, subsequent to our decision in this case, the U.S. Supreme Court decided *Dobson*. On June 12, 1995, the same Court vacated our prior *Casarotto* decision and remanded the matter to this Court for further consideration in light of the *Dobson* decision.

In *Dobson*, the plaintiffs were the assignees of a contract with Terminix for life-time protection against termites. They sued Terminix in Alabama state court when they found their house "swarming with termites." Terminix moved the court for a stay pursuant to § 2 of the Federal Arbitration Act (9 U.S.C. § 2 (1988)) so that arbitration could proceed pursuant to a provision for arbitration in the termite protection plan. The stay was denied. The Supreme Court of Alabama upheld the denial on the basis of Ala. Code § 8-1-41(3) (1993), which made written, predispute arbitration agreements invalid and unenforceable. The Alabama court concluded that its state statute was not preempted by the Federal Arbitration Act because the connection between the termite contract and interstate commerce was too slight.

> In the court's view, the Act applies to a contract only if "'at the time [the parties entered into the contract] and accepted the arbitration clause, they *contemplated* substantial interstate activity.'" Despite some interstate activities (*e.g.*, Allied-Bruce, like Terminix, is a multistate firm and shipped treatment and repair material from out of state), the court found that the parties "contemplated" a transaction that was primarily local and not "substantially" interstate.

Dobson, 115 S. Ct. at 837 (citations omitted).

Before addressing the issue presented, the *Dobson* majority reiterated its conclusion that the purpose of the Federal Arbitration Act was to "overcome judicial hostility to arbitration agreements and that applies in both federal and state courts." *Dobson*, 115 S. Ct. at 835. The Court then went on to

conclude that the language in § 2 of the Act which applied its provisions to any "contract evidencing a transaction involving commerce" had broader significance than the words of art "in commerce," and therefore, covered more than persons or activities "within the flow" of interstate commerce. *Dobson*, 115 S. Ct. at 839. The Court held that the word "involving," like "affecting," signaled an intent on the part of Congress "to exercise Congress's commerce power to the full," *Dobson*, 115 S. Ct. at 841, and secondly that the Act's preemptive force applies to transactions which, in fact, involve interstate commerce, even though a connection to interstate commerce may not have been contemplated by the parties at the time they entered into the agreement. For these reasons, the judgment of the Supreme Court of Alabama was reversed. *Dobson*, 115 S. Ct. at 843.

After careful review, we can find nothing in the *Dobson* decision which relates to the issues presented to this Court in this case. Our prior *Casarotto* decision did not involve state law which made arbitration agreements invalid and unenforceable. Our state law simply requires that the parties be adequately informed of what they are doing before they enter into an arbitration agreement. Our decision did not involve an analysis of what was meant by "involving commerce" or "affecting commerce" or "in commerce." We assumed, in the *Casarotto* decision, that the transaction with which we were concerned involved interstate commerce, and that any state law which frustrated the purposes of the Federal Arbitration Act would be preempted.

Finally, there is no suggestion in the *Dobson* decision that the principles from *Volt* on which we relied have been modified in any way. To our knowledge, it is still the law, therefore, that state law is only preempted to the extent that it "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Volt*, 489 U.S. at 477, 109 S. Ct. at 1255 (citing *Hines v. Davidowitz* (1941), 312 U.S. 52, 67, 61 S. Ct. 399, 404, 85 L. Ed. 2d 581).

While the *Dobson* decision does include a discussion extolling the virtues of arbitration as a "less expensive alternative to litigation," *Dobson*, 115 S. Ct. at 843 (apparently based on input from the American Arbitration Association), and while that conclusion is at odds with facts set forth in Justice Trieweiler's concurring opinion to our earlier decision, the concurring opinion was not the basis for our decision.

For these reasons, we conclude, after thorough review of our earlier decision in light of the U.S. Supreme Court's decision in *Dobson*, that the decisions are not inconsistent, and therefore, that there is no basis for modifying or reversing our earlier opinion. We reaffirm and reinstate our opinion dated December 15, 1994, in the above matter, and remand this case to the District Court for further proceedings consistent with this opinion.

/s/ Terry N. Trieweiler
Justice

We concur:

/s/ James C. Nelson
/s/ William E. Hunt, Sr.
/s/ W. William Leaphart
Justices

Justice W. William Leaphart, specially concurring.

Justice John C. Harrison was in the majority in this Court's initial decision in Casarotto v. Lombardi (1994), 268 Mont. 369, 886 P.2d 931. Justice Harrison has since retired. As the successor to Justice Harrison, it is incumbent on me to review that decision in light of the remand from the United States Supreme Court. Having reviewed the *Casarotto* decision, I specially concur with the Court's conclusion that Montana's notice requirement in § 27-5-114(4), MCA, does not undermine the goals and policies of the FAA and is not preempted by 9 U.S.C. § 2 (1988). I have also reviewed the United States Supreme Court's decision in Allied-Bruce Terminix Cos. v. Dobson (1995), 115 S.Ct. 834, 130 L.Ed.2d 753, and I see no reason why the principles enunciated in that decision should have any effect upon this Court's decision in *Casarotto*.

In *Dobson*, the United States Supreme Court held that the FAA preempts anti-arbitration state statutes which invalidate arbitration agreements. Section 27-5-114(4), MCA, cannot be characterized as anti-arbitration nor does it invalidate arbitration agreements. On the contrary, it is one section of Montana's Uniform Arbitration Act which specifically recognizes arbitration agreements: "A written agreement to submit an existing controversy to arbitration is valid and enforceable except upon such grounds as exist at law or in equity for the revocation of a contract." Section 27-5-114(1), MCA. The notice requirement of subsection (4) merely protects the consumer by requiring that notice of an arbitration provision be conspicuously placed on the front page of the contract. This does not undermine the pro-arbitration policy of the FAA. Rather, it furthers the policy of meaningful and consensual arbitration by helping ensure that the consumer who signs what is most often a nonnegotiated, form contract, knowingly agrees to arbitration in the event of a dispute. I see no inconsistency between *Dobson* and our decision in *Casarotto* and I specially concur in the Court's decision to reaffirm and reinstate its December 15, 1994 opinion.

/s/ W. William Leaphart
Justice

Justice Karla M. Gray, dissenting.

I dissent from the Court's opinion and order and its reinstatement of its prior opinion in this case. My dissent is based on the procedures used by the Court in addressing the United States Supreme Court's vacating of our earlier opinion and remanding for our reconsideration based on its decision in Allied-Bruce Terminix Cos. v. Dobson (1995), 115 S.Ct. 834, 130 L.Ed.2d 753. I also dissent from the Court's conclusion that nothing in the *Dobson* case relates to the issues presented to this Court. In dissenting, I also reaffirm and reinstate my earlier dissent in this case.

A remand for reconsideration to this Court from the United States Supreme Court is an uncommon occurrence for which we have no procedural rules or practices in place. Counsel for the parties were left without guidance as to how they should proceed in order to be heard during this phase of the case. Counsel for the defendants/respondents requested the opportunity to brief the issues raised by the United States Supreme Court's remand and to present oral argument. Without so much as a mention of this request, the Court apparently denies it. While one can only speculate on the reasons for such an implicit decision, one must assume that the Court is simply unwilling to consider any analysis that would require a change in the result it remains determined to reach. I cannot join in such an arrogant and cavalier approach to this important case on remand from the United States Supreme Court.

More importantly, I disagree with the Court's conclusion that nothing in *Dobson* relates to the issues before us. While I agree that the substantive issue addressed at length in *Dobson* is not before us here, I read more importance into the early language in *Dobson* than does the Court. In *Dobson*, the United States Supreme Court reiterates the fundamental premise of the Federal Arbitration Act by citing to *Volt*, the very case which this Court erroneously interprets and on which it premises its erroneous decision, for the proposition that "the basic purpose of the Federal Arbitration Act is to overcome courts' refusals to enforce agreements to arbitrate."

Dobson, 115 S.Ct. at 838; citing Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ. (1989), 489 U.S. 468, 474. The Supreme Court goes on to say that "[n]othing significant has changed in the 10 years subsequent to *Southland*; no later cases have eroded *Southland's* authority[.]" *Dobson*, 115 S.Ct. at 839. It is this latter statement on which I believe we must focus in reconsidering our decision here. The Court refuses to do so.

I continue to believe that this Court erroneously interprets *Volt*, which was decided by the Supreme Court five years after *Southland*. *Volt* is clearly distinguishable on its facts from the case before this Court and cannot properly serve as a basis for the result the Court reaches. *Volt* is neither inconsistent with, nor a retrenchment from, *Southland*, as this Court suggested in its earlier opinion and suggests again today. This is the message I take from the Supreme Court's statement in *Dobson* that "no later cases have eroded *Southland's* authority;" this is the portion of this Court's earlier opinion to which I believe the Supreme Court was directing our attention on remand.

For the reasons stated in my earlier dissent, it is my view that application of Montana's notice statute is preempted by the Federal Arbitration Act in this case because application of that statute undercuts, undermines and renders unenforceable the parties' agreement to arbitrate. This view is entirely consistent both with *Southland* and with a proper interpretation of *Volt*. Therefore, I dissent from the Court's opinion and order and reinstate my prior dissent in this case.

/s/ Karla M. Gray
Justice

Chief Justice J.A. Turnage and Justice Fred J. Weber join in the foregoing dissent of Justice Karla M. Gray.

/s/ J.A. Turnage
Chief Justice

/s/ Fred J. Weber
Justice

APPENDIX B

[Filed Dec. 15, 1994]

IN THE SUPREME COURT
OF THE STATE OF MONTANA
1994

No. 93-488

PAUL CASAROTTO and PAMELA CASAROTTO,
Plaintiffs and Appellants,

v.

NICK LOMBARDI and DOCTOR'S ASSOCIATES, INC.,
Defendants and Respondents,

and

DANIEL L. and DEB HUDSON, and
D&D SUBWAY CORPORATION,
Defendants.

Appeal from District Court of the Eighth Judicial District,
In and for the County of Cascade,
The Honorable John M. McCarvel, Judge presiding

Submitted: April 19, 1994

Decided: December 15, 1994

Justice Terry N. Trieweiler delivered the opinion of the Court.

Plaintiffs Paul and Pamela Casarotto filed this suit in the District Court for the Eighth Judicial District in Cascade County to recover damages which they claim were caused by the defendants' breach of contract and tortious conduct. Defendants Nick Lombardi and Doctor's Associates, Inc. (DAI), moved the District Court for an order dismissing plaintiffs' complaint, or in the alternative, staying further judicial proceedings pending arbitration of plaintiffs' claims pursuant to a provision in DAI's franchise agreement with plaintiffs which required that disputes "arising out of or relating to" that contract be settled by arbitration. The District Court granted defendants' motion, and ordered that further judicial proceedings be stayed until arbitration proceedings were completed in accordance with the terms of the parties' agreement. Plaintiffs appeal from that order. We reverse the order of the District Court.

The issues raised on appeal are:

1. Based on conflict of law principles, is the franchise agreement entered into between the Casarottos and DAI governed by Connecticut law or Montana law?

2. If the contract is governed by Montana law, is the notice requirement in § 27-5-114(4), MCA, of Montana's Uniform Arbitration Act, preempted by the Federal Arbitration Act found at 9 U.S.C. §§ 1-15 (1988)?

FACTUAL BACKGROUND

On October 29, 1992, Paul and Pamela Casarotto filed an amended complaint naming Doctor's Associates, Inc., and Nick Lombardi as defendants. For purposes of our review of the District Court's order, we presume the facts alleged in the complaint to be true.

DAI is a Connecticut corporation which owns Subway Sandwich Shop franchises, and Lombardi is their development agent in Montana. The Casarottos entered into a franchise agreement with DAI which allowed them to

open a Subway Sandwich Shop in Great Falls, Montana. However, they were told by Lombardi that their first choice for a location in Great Falls was unavailable.

According to their complaint, the Casarottos agreed to open a shop at a less desirable location, based on a verbal agreement with Lombardi that when their preferred location became available, they would have the exclusive right to open a store at that location. Contrary to that agreement, the preferred location was subsequently awarded by Lombardi and DAI to another franchise. As a result, the Casarottos' business suffered irreparably, and they lost their business, along with the collateral which secured their SBA loan.

This action is based on the Casarottos' allegation that Lombardi and DAI breached their agreement with the Casarottos, defrauded them, breached the covenant of good faith and fair dealing, and engaged in other tortious conduct, all of which directly caused the Casarottos loss of business and the resulting damage.

DAI's franchise agreement with the Casarottos was executed on April 25, 1988. There was no indication on the first page of the contract that it was subject to arbitration. However, paragraph 10(c) of the contract, found on page 9, included the following provision:

> Any controversy or claim arising out of or relating to this contract or the breach thereof shall be settled by Arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association at a hearing to be held in Bridgeport, Connecticut and judgment upon an award rendered by the Arbitrator(s) may be entered in any court having jurisdiction thereof. The commencement of arbitration proceedings by an aggrieved party to settle disputes arising out of or relating to this contract is a condition precedent to the commencement of legal action by either party. The cost

> of such a proceeding will be born equally by the parties.

On January 29, 1993, DAI moved the District Court to dismiss the Casarottos' complaint, or at least stay further judicial proceedings, pending arbitration pursuant to paragraph 10(c) of the franchise agreement. DAI alleged that the franchise agreement affected interstate commerce, and therefore, was subject to the Federal Arbitration Act found at 9 U.S.C. §§ 1-15 (1988). They sought a stay of proceedings pursuant to § 3 of that Act, which provides in relevant part that:

> If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement . . . .

DAI claimed that Montana law could not be raised as a bar to enforcement of the arbitration provision for two reasons: First, the contract specifically called for the application of Connecticut law; and second, Montana law was preempted by the Federal Arbitration Act.

The Casarottos opposed DAI's motion on the grounds that Montana law applied, in spite of the choice of law provision in the contract, and that based on § 27-5-114 (4), MCA, the contract's arbitration provision was unenforceable because DAI had not provided notice on the first page of the agreement that the contract was subject to arbitration.

On June 2, 1993, the District Court issued its order granting DAI's motion to stay further judicial proceedings pursuant to 9 U.S.C. § 3. The order was made applicable to both DAI and Lombardi, but not to other named defendants who were not parties to the franchise agreement and whose alleged conduct raises other issues. On July 8, 1993, the District Court issued an order pursuant to Rule 54(b), M.R.Civ.P., certifying its June 2 order as final for purposes of appeal. The Casarottos appeal from that order.

ISSUE 1

Based on conflict of law principles, is the franchise agreement entered into between the Casarottos and DAI governed by Connecticut law or Montana law?

Paragraph 12 of the franchise agreement entered into between the parties provides as follows: "This agreement shall be governed by and construed in accordance with the laws of the State of Connecticut and contains the entire understanding of the parties." DAI contends that, therefore, Connecticut law governs our interpretation of the contract and that since Connecticut law is identical to the Federal Arbitration Act *see* Conn. Gen. Stat. § 52-409 (1993), conspicuous notice that the contract was subject to arbitration was not required and we need not concern ourselves with the issue of whether Montana law is preempted.

The Casarottos respond that the issue of whether to apply Connecticut or Montana law involves a conflict of law issue and that the answer can be found in our prior decisions. We agree.

In *Emerson v. Boyd* (1991), 247 Mont. 241, 805 P.2d 587, we cited with approval the Ninth Circuit's decision in *R.J. Williams Co. v. Fort Belknap Housing Authority* (9th Cir. 1983), 719 F.2d 979, which adopted the criteria established in Restatement (Second) of Conflict of Laws § 188 (1971) to determine which jurisdiction's laws apply to a contract where no choice of law is provided for in the contract. Section 188 provides as follows:

(1) The rights and duties of the parties with respect to an issue in contract are determined by the local law of the state which, with respect to that issue, has the most significant relationship to the transaction and the parties under the principles stated in § 6.

(2) In the absence of an effective choice of law by the parties (see § 197), the context to be taken into account in applying the principles of § 6 to determine the law applicable to an issue include:

(a) the place of contracting,

(b) the place of negotiation of the contract,

(c) the place of performance,

(d) the location of the subject matter of the contract, and

(e) the domicil, residence, nationality, place of incorporation and place of business of the parties.

These contracts are to be evaluated according to their relative importance with respect to the particular issue.

(3) If the place of negotiating the contract and the place of performance are in the same state, the local law of this state will usually be applied, except as otherwise provided in §§ 189-199 and 203.

In this case, there is a choice of law provision in the parties' contract. The question is whether it was an "effective" choice. We recently held in *Youngblood v. American States Ins. Co.* (1993), 262 Mont. 391, 394, 866 P.2d 203, 205, that this State's public policy will ultimately determine whether choice of law provisions in contracts are "effective." In that case, we stated:

> Here, the general policy language in the insurance contract requires American States to pay whatever damages are required in Montana; that is, the contract is to be performed in Montana. Therefore, unless a contract term provides otherwise, *Kemp* [*v. Allstate Ins. Co. (1979), 183 Mont. 526, 601 P.2d 20*] and § 28-3-102, MCA, require the application of Montana law because the contract was to be 'performed' in Montana. In this case, however, the insurance contract contains a choice of law provision which requires the application of Oregon subrogation law. . . .
>
> . . . .
>
> . . . [T]he choice of law provision will be enforced unless enforcement of the contract provision requiring application of Oregon law as regards subrogation of medical payments violates Montana's public policy or is against good morals.

Youngblood, 866 P.2d at 205.

Based on our conclusion in that case that subrogation of medical payment benefits was contrary to our public policy, we held that:

> [T]he choice of law provision in the insurance contract would result in medical payment subrogation under Oregon law. Because such subrogation violates Montana's public policy, that term of the insurance contract at issue here is not enforceable.

Youngblood, 866 P.2d at 208.

Restatement (Second) of Conflict of Laws § 187(2) (1971) is consistent with our decision in *Youngblood*, and expands upon the factors to be considered under the circumstances in this case. It provides that:

> (2) The law of the state chosen by the parties to govern their contractual rights and duties will be applied, even if the particular issue is one which the parties could not have resolved by an explicit provision in their agreement directed to that issue, unless either

(a) the chosen state has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties' choice, or

(b) application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue and which, under the rule of § 188, would be the state of the applicable law in the absence of an effective choice of law by the parties.

Adopting § 187, then, as our guide, we first look to § 188 to determine whether Montana law would be applicable absent an "effective" choice of law by the parties.

According to the affidavit of Paul Casarotto filed in opposition to DAI's motion to dismiss, he executed the contract in neither Connecticut nor Montana. It was executed while he was traveling in New York. However, it appears from that same affidavit, and from the allegations in the complaint, that original negotiations were conducted by him in Great Falls, the contract was to be performed in Great Falls, the subject matter of the contract (the Subway Sandwich Shop) was located in Great Falls, and that he and Pamela Casarotto resided in Great Falls at the time that the contract was executed. The only connection to Connecticut was that DAI was incorporated in that state and apparently had its home office in that state at the time of the parties' agreement. We conclude that based upon the application of the criteria set forth in § 188, and our prior decision in *Emerson*, Montana has a materially greater interest than Connecticut in the contract issue that is presented, and that absent an "effective" choice of law by the parties, Montana law would apply.

Our remaining inquiry, then, is whether application of Connecticut law would be contrary to a fundamental

policy of this State by eliminating the requirement that notice be provided when a contract is subject to arbitration.

In *Trammel v. Brotherhood of Locomotive Firemen and Enginemen* (1953), 126 Mont. 400, 409, 253 P.2d 329, 334, we held that the public policy of a state is established by its express legislative enactments. Here, the legislative history for § 27-5-114(4), MCA, makes clear that the legislative committee members considering adoption of the Uniform Arbitration Act had two primary concerns. First, they did not want Montanans to waive their constitutional right of access to Montana's courts unknowingly, and second, they were concerned about Montanans being compelled to arbitrate disputes at distant locations beyond the borders of our State.

The facts in this case, and our recent decision in another case, justify those concerns.

Regardless of the amount in controversy between these parties, the arbitration clause in the Subway Sandwich Shop Franchise Agreement requires that the Casarottos travel thousands of miles to Connecticut to have their dispute arbitrated. Furthermore, it requires that they share equally in the expense of arbitration, regardless of the merits of their claim. Presumably, that expense could be substantial, since under the Commercial Arbitration Rules of the American Arbitration Association (1992), those expenses would, at a minimum, include: the arbitrator's fees and travel expenses, the cost of witnesses chosen by the arbitrator, the American Arbitration Association's administrative charges, and a filing fee of up to $4000, depending on the amount in controversy. For a proceeding involving multiple arbitrators, the administrative fee alone, for which the Casarottos would be responsible, is $150 a day. In addition, since the contract called for the application of Connecticut law, the Casarottos would be required to retain the services of a Connecticut attorney.

In spite of the expense set forth above, the procedural safeguards which have been established in Montana to assure the reliability of the outcome in dispute resolutions are absent in an arbitration proceeding. The extent of pretrial discovery is within the sole discretion of the arbitrator and the rules of evidence are not applicable. The arbitrator does not have to follow any law, and there does not have to be a factual basis for the arbitrator's decision. *See May v. First National Pawn Brokers, Ltd.* (Mont. Dec. 15, 1994), Slip Op. 94-189.

Based upon the determination by the Legislature of this State that the citizens of this State are at least entitled to notice before entering into an agreement which will limit their future resolution of disputes to a procedure as potentially inconvenient, expensive, and devoid of procedural safeguards as the one provided for by the rules of the American Arbitration Association, and the terms of this contract, we conclude that the notice requirement of § 27-5-114, MCA, does establish a fundamental public policy in Montana, and that the application of Connecticut law would be contrary to that policy. Therefore, we conclude that the law of Montana governs the franchise agreement entered into between the Casarottos and Doctor's Associates, Inc.

ISSUE 2

If the contract is governed by Montana law, is the notice requirement in § 27-5-114(4), MCA, of Montana's Uniform Arbitration Act, preempted by the Federal Arbitration Act found at 9 U.S.C. §§ 1-15 (1988)?

DAI contends that even if Montana law is applicable, § 27-5-114(4), MCA, is preempted by the Federal Arbitration Act because it would void an otherwise enforceable arbitration agreement. In support of its argument, DAI relies on U.S. Supreme Court decisions in *Perry v. Thomas* (1987), 482 U.S. 483, 107 S. Ct. 2520, 96 L. Ed. 2d 426, *Southland Corp. v. Keating* (1984), 465

U.S. 1, 104 S. Ct. 852, 79 L. Ed. 2d 1, and *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.* (1983), 460 U.S. 1, 103 S. Ct. 927, 74 L. Ed. 2d 765. These cases have been referred to as "[a] trilogy of United States Supreme Court cases" which "developed the federal policy favoring arbitration and the principle that the FAA is substantive law enacted pursuant to Congress's commerce powers that preempts contrary state provisions." David P. Pierce, *The Federal Arbitration Act: Conflicting Interpretations of its Scope* 61 Cinn. L. Rev. 623, 630 (1992). From this trilogy, *Southland* and *Perry* appear to be closest on point and warrant some discussion.

Southland Corporation was the owner and franchisor of 7-Eleven Convenience Stores. Its standard franchise agreements, like DAI's included an arbitration provision. Southland was sued in California by several of its franchisees, based on claims which included violations of the disclosure requirements of the California Franchise Investment Law, Cal. Corp. Code § 31000, *et seq.* (West 1977). The California Supreme Court held that the Franchise Investment Law required judicial consideration of claims brought under that statute, and therefore, held that arbitration could not be compelled. The U.S. Supreme Court disagreed, and held that:

> In creating a substantive rule applicable in state as well federal courts, Congress intended to foreclose state legislative attempts to undercut the enforceability of arbitration agreements. We hold that § 31512 of the California Franchise Investment Law violates the Supremacy Clause.

Southland, 465 U.S. at 16 (footnotes omitted).

In *Perry*, the Supreme Court was called upon to reconcile 9 U.S.C. § 2 which mandates enforcement of arbitration agreements, with § 229 of the California Labor Code, "which provides that actions for the collection of wages may be maintained 'without regard to the existence of

any private agreement to arbitrate.'" *Perry*, 465 U.S. at 484 (quoting Cal. Lab. Code § 229 (West 1971)). In that case, Kenneth Thomas sued his former employer for commissions he claimed were due for the sale of securities. His employer sought to stay the proceedings pursuant to §§ 2 and 4 of the Federal Arbitration Act, based on the arbitration provision found in Thomas's application for employment. *Perry*, 465 U.S. at 484-85. In an opinion affirmed by the California Court of Appeals and the California Supreme Court, the California Superior Court denied the motion to compel arbitration. On appeal, the U.S. Supreme Court held that § 2 of the FAA reflected a strong national policy favoring arbitration agreements, notwithstanding "state substantive or procedural policies to the contrary." *Perry*, 482 U.S. at 489. Citing its decision in *Southland*, the Court held that:

> "Congress intended to foreclose state legislative attempts to undercut the enforceability of arbitration agreements." Id. at 16 (footnote omitted). Section 2, therefore, embodies a clear federal policy of requiring arbitration unless the agreement to arbitrate is not part of a contract evidencing interstate commerce or is revocable "upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. "We see nothing in the Act indicating that the broad principle of enforceability is subject to any additional limitations under state law." *Keating, supra*, at 11.

Perry, 482 U.S. at 489-90.

As additional authority, DAI cites to our own previous decisions which have enforced arbitration agreements in Montana based on *Southland* and *Perry*. *See Downey v. Christensen* (1992), 251 Mont. 386, 825 P.2d 557; *Vukasin v. D.A. Davidson & Co.* (1990), 241 Mont. 126, 785 P.2d 713; *William Gibson, Jr., Inc. v. James Graff Communications* (1989), 239 Mont. 335, 780 P.2d 1131; *Larsen v. Opie* (1989), 237 Mont. 108, 771 P.2d

977; *Passage v. Prudential-Bache Securities, Inc.* (1986), 223 Mont. 60, 727 P.2d 1298.

The Casarottos, however, contend that *Southland* and *Perry* must be considered in light of the Supreme Court's more recent decision in *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University* (1989), 489 U.S. 468, 109 S.Ct. 1248, 103 L.Ed. 2d 488, and that our prior arbitration decisions did not deal with the enforceability of arbitration agreements which violated Montana's statutory law. We agree.

In *Volt*, the parties entered into a construction contract which contained an agreement to arbitrate all disputes between the parties relating to the contract. The contract also provided that it would be governed by the law in the state where the project was located. *Volt*, 489 U.S. at 470.

As a result of a contract dispute between the parties, Stanford filed an action in California Superior Court naming Volt and two other companies involved in the construction project. Volt petitioned the Superior Court to compel arbitration of the dispute. However, the California Arbitration Act found at Cal. Civ. Proc. Code § 1280, *et seq.* (West 1982), contained a provision allowing the court to stay arbitration pending resolution of related litigation. On that basis, the Superior Court denied Volt's motion to compel arbitration, and instead, stayed arbitration proceedings pending outcome of the litigation. The California Court of Appeals affirmed that decision, and the California Supreme Court denied Volt's petition for discretionary review. The U.S. Supreme Court granted review and affirmed the decision of the California courts. *Volt*, 489 U.S. at 471-73.

On appeal, the Supreme Court considered Volt's argument that California's arbitration laws were preempted by the Federal Arbitration Act. In its analysis of the preemption issue, the Supreme Court stated that:

> The FAA contains no express pre-emptive provision, nor does it reflect a congressional intent to occupy the entire field of arbitration. But even when Congress has not completely displaced state regulation in an area, state law may nonetheless be pre-empted to the extent that it actually conflicts with federal law—that is, to the extent that it "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941). *The question before us, therefore, is whether application of Cal.Civ.Proc. Code Ann. § 1281.2(c) to stay arbitration under this contract in interstate commerce, in accordance with the terms of the arbitration agreement itself, would undermine the goals and policies of the FAA. We conclude that it would not.*

Volt, 489 U.S. at 477-78 (citation omitted; emphasis added).

The Supreme Court explained that the purpose of the Federal Arbitration Act was to enforce lawful agreements entered into by the parties, and not to impose arbitration on the parties involuntarily. It noted that in this case the parties' agreement was to be bound by the arbitration rules from California. Therefore, it held that:

> Where, as here, the parties have agreed to abide by state rules of arbitration, enforcing those rules according to the terms of the agreement is fully consistent with the goals of the FAA, even if the result is that arbitration is stayed where the Act would otherwise permit it to go forward. By permitting the courts to "rigorously enforce" such agreements according to their terms, see [*Dean Witter Reynolds, Inc. v.*]*Byrd*, [470 U.S.] at 221, we give effect to the contractual rights and expectations of the parties, without doing violence to the policies behind the FAA.

Volt, 489 U.S. at 479.

While the Court in *Volt* applied state laws that had been chosen by the parties in their contract, and this case involves state law which is applied pursuant to conflict of law principles, it has been observed that:

> The real significance of the *Volt* decision is not in the Court's holding, but rather in what the Court failed to hold. For example, the Court found no preemption of the California arbitration law by the FAA. Instead, the Court merely stated that Congress did not intend that the FAA occupy the entire field of arbitration law. Thus, enforcing the California law was merely a procedural issue and did not frustrate the policy behind the FAA of enforcing the agreement.

David P. Pierce, *The Federal Arbitration Act: Conflicting Interpretations of its Scope* 61 Cinn. L. Rev. 623, 635 (1992) (footnotes omitted).

Section 2 of 9 U.S.C. provides that:

> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, *save upon such grounds as exist at law or in equity for the revocation of any contract*.

(Emphasis added.)

Based upon the Supreme Court's decision in *Volt*, we conclude that the nature of our inquiry is whether Montana's notice requirement found at § 27-5-114(4), MCA, would "undermine the goals and policies of the FAA." We conclude that it does not.

DAI relies on decisions in *Threlkeld & Co., Inc. v. Metallgesellschaft Ltd.* (2d Cir. 1991), 923 F.2d 245, *Securities Industry Ass'n v. Connolly* (1st Cir. 1989), 883 F.2d 1114, *Webb v. R. Rowland & Co., Inc.* (8th Cir. 1986), 800 F.2d 803, and *Bunge Corp. v. Perryville Feed & Produce, Inc.* (Mo. 1985), 685 S.W.2d 837, in support of its argument that notice provisions are preempted by federal law.

The Casarottos, on the other hand, rely on decisions in *American Physicians v. Port Lavaca Clinic* (Tex. Ct. App. 1992), 843 S.W.2d 675, and *Albright v. Edward D. Jones & Co.* (Ind. Ct. App. 1991), 571 N.E.2d 1329, for the principle that since *Volt*, other courts have held that notice provisions in state arbitration laws are not preempted by the Federal Arbitration Act.

However, the cases cited by the parties either precede the Supreme Court's decision in *Volt*, or contain little or no reference to the *Volt* decision. We conclude that none are persuasive, and we must rely on our own analysis of whether Montana's notice requirement undermines the goals and policies of the FAA.

Our conclusion that Montana's notice requirement does not undermine the policies of the FAA is based on the Supreme Court's conclusion that it was never Congress's intent when it enacted the FAA to preempt the entire field of arbitration, and its further conclusion that the FAA does not require parties to arbitrate when they have not agreed to do so. That Court held that the purpose of the FAA is simply to enforce arbitration agreements into which parties had entered, and acknowledged that the interpretation of contracts is ordinarily a question of state law. *Volt*, 489 U.S. at 474.

Presumably, therefore, the Supreme Court would not find it a threat to the policies of the Federal Arbitration Act for a state to require that before arbitration agreements are enforceable, they be entered knowingly. To

hold otherwise would be to infer that arbitration is so onerous as a means of dispute resolution that it can only be foisted upon the uninformed. That would be inconsistent with the conclusion that the parties to the contract are free to decide how their disputes should be resolved.

Montana's notice requirement does not preclude parties from knowingly entering into arbitration agreements, nor do our courts decline to enforce arbitration agreements which are entered into knowingly.

Therefore, we conclude that Montana's notice statute found at § 27-5-114(4), MCA, would not undermine the goals and policies of the FAA, and is not preempted by 9 U.S.C. § 2 (1988).

Because the agreement of the parties in this case did not comply with Montana's statutory notice requirement, it is not subject to arbitration, according to the law of Montana. The District Court's order dated June 2, 1993, is, therefore, reversed, and this case is remanded to the District Court for further proceedings consistent with this opinion.

/s/ Terry Trieweiler
Justice

We concur:

/s/ John Conway Harrison

/s/ William E. Hunt, Sr.

/s/ James C. Nelson
Justices

Justice Terry N. Trieweiler specially concurring.

The majority opinion sets forth principles of law agreeable to the majority of this Court in language appropriate for judicial precedent. I offer this special concurring opinion as my personal observation regarding many of the federal decisions which have been cited to us as authority.

To those federal judges who consider forced arbitration as the panacea for their "heavy case loads" and who consider the reluctance of state courts to buy into the arbitration program as a sign of intellectual inadequacy, I would like to explain a few things.

In Montana, we are reasonably civilized and have a sophisticated system of justice which has evolved over time and which we continue to develop for the primary purpose of assuring fairness to those people who are subject to its authority.

Over the previous 100 years of our history as a state, our courts have developed rules of evidence for the purpose of assuring that disputes are resolved on the most reliable bases possible.

Based on the presumption that all men and women are fallible and make mistakes, we have developed standards for appellate review which protect litigants from human error or the potential arbitrariness of any one individual.

We believe in the rule of law so that people can plan their commercial and personal affairs. If our trial courts decline to follow those laws, our citizens are assured that this Court will enforce them.

We have rules for venue, and jurisdictional requirements based on the assumption that it is unfair to force people to travel long distances from their homes at great expense and inconvenience to prosecute or defend against lawsuits.

We believe that our courts should be accessible to all, regardless of their economic status, or their social importance, and therefore, provide courts at public expense and guarantee access to everyone.

We have developed liberal rules of discovery (patterned after the federal courts) based on the assumption that the open and candid exchange of information is the surest way to resolve claims on their merits and avoid unnecessary trials.

We have contract laws and tort laws. We have laws to protect our citizens from bad faith, fraud, unfair business practices, and oppression by the many large national corporations who control many aspects of their lives but with whom they have no bargaining power.

While our system of justice and our rules are imperfect, they have as their ultimate purpose one overriding principle. They are intended, and continue to evolve, for the purpose of providing fairness to people, regardless of their wealth or political influence.

What I would like the people in the federal judiciary, especially at the appellate level, to understand is that due to their misinterpretation of congressional intent when it enacted the Federal Arbitration Act, and due to their naive assumption that arbitration provisions and choice of law provisions are knowingly bargained for, all of these procedural safeguards and substantive laws are easily avoided by any party with enough leverage to stick a choice of law and an arbitration provision in its preprinted contract and require the party with inferior bargaining power to sign it.

The procedures we have established, and the laws we have enacted, are either inapplicable or unenforceable in the process we refer to as arbitration.

I am particularly offended by the attitude of federal judges, typified by the remarks of Judge Selya in the First Circuit, which were articulated in *Securities Industry Ass'n v. Connolly* (1st Cir. 1989), 883 F.2d 1114,

cert. denied (1990), 495 U.S. 956, 110 S. Ct. 2559, 109 L. Ed. 2d 742.

Judge Selya considered "[i]ncreased resort to the courts" as the cause for "tumefaction of already-swollen court calendars." He refers to arbitration as "a contractual device that relieves some of the organic pressure by operating as a shunt, allowing parties to resolve disputes outside of the legal system." *Connolly,* 883 F.2d at 1116. He states that "[t]he hope has long been that the Act could serve as a therapy for the ailment of the crowded docket." *Connolly,* 883 F.2d at 1116. He then bemoans that fact that, "[a]s might be expected, there is a rub: the patient, and others in interest, often resist the treatment." *Connolly,* 883 F.2d at 1116.

Judge Selya refers to the preference in the various state jurisdictions to resolve disputes according to traditional notions of fairness, and then suggests that "[t]he FAA was enacted to overcome this 'anachronism'." *Connolly,* 883 F.2d at 1119 (citation omitted). He considers it the role of federal courts to be "on guard for artifices in which the ancient suspicion of arbitration might reappear." *Connolly,* 883 F.2d at 1119.

This type of arrogance not only reflects an intellectual detachment from reality, but a self-serving disregard for the purposes for which courts exist.

With all due respect, Judge Selya's opinion illustrates an all too frequent preoccupation on the part of federal judges with their own case load and a total lack of consideration for the rights of individuals. Nowhere in Judge Selya's lengthy opinion is there any consideration for the total lack of procedural safeguards inherent in the arbitration process. Nowhere in his opinion does he consider the financial hardship that contracts, like the one in this case, impose on people who simply cannot afford to enforce their rights by the process that has been forced upon them. Nowhere does Judge Selya acknowledge that the

"patient" (presumably courts like this one) who resists the "treatment" (presumably the imposition of arbitration in lieu of justice) has a case load typically three times as great as Justice Selya's case load.

The notion by federal judges, like Judge Selya, that people like the Casarottos have knowingly and voluntarily bargained and agreed to resolve their contractual disputes or tort claims by arbitration, is naive at best, and self-serving and cynical at worst. To me, the idea of a contract or agreement suggests mutuality. There is no mutuality in a franchise agreement, a securities brokerage agreement, or in any other of the agreements which typically impose arbitration as the means for resolving disputes. National franchisors, like the defendant in this case, and brokerage firms, who have been the defendants in many other arbitration cases, present form contracts to franchisees and consumers in which choice of law provisions and arbitration provisions are not negotiable, and the consequences of which are not explained. The provision is either accepted, or the business or investment opportunity is denied. Yet these provisions, which are not only approved of, but encouraged by people like Judge Selya, do, in effect, subvert our system of justice as we have come to know it. If any foreign government tried to do the same, we would surely consider it a serious act of aggression.

Furthermore, if the Federal Arbitration Act is to be interpreted as broadly as some of the decisions from our federal courts would suggest, then it presents a serious issue regarding separation of powers. What these interpretations do, in effect, is permit a few major corporations to draft contracts regarding their relationships with others that immunizes them from accountability under the laws of the states where they do business, and by the courts in those states. With a legislative act, the Congress, according to some federal decisions, has written state and federal courts out of business as far as these corporations

are concerned. They are not subject to California's labor laws or franchise laws, they are not subject to our contract laws or tort laws. They are, in effect, above the law.

These insidious erosions of state authority and the judicial process threaten to undermine the rule of law as we know it.

Nothing in our jurisprudence appears more intellectually detached from reality and arrogant than the lament of federal judges who see this system of imposed arbitration as "therapy for their crowded dockets." These decisions have perverted the purpose of the FAA from one to accomplish judicial neutrality, to one of open hostility to any legislative effort to assure that unsophisticated parties to contracts of adhesion at least understand the rights they are giving up.

It seems to me that judges who have let their concern for their own crowded docket overcome their concern for the rights they are entrusted with should step aside and let someone else assume their burdens. The last I checked, there were plenty of capable people willing to do so.

/s/ Terry Trieweiler
Justice

Justice Fred J. Weber dissents as follows:

I respect the majority opinion in its expression of the deeply held conviction that arbitration of the type expressed in the contract in this case should not be enforced in Montana and thereby deprive the parties of access to the court system. The answer to such a judicial approach was stated by the United States Supreme Court in Volt Info. Sciences v. Bd. of Trustees (1989), 489 U.S. 468, 478, 109 S.Ct. 1248, 1255, 103 L.Ed.2d 488, 497, in which the United States Supreme Court stated:

> The Act [Federal Arbitration Act] was designed "to overrule the judiciary's longstanding refusal to enforce agreements to arbitrate," . . . and place such agreements "upon the same footing as other contracts," . . . Section 2 of the Act therefore declares that a written agreement to arbitrate in any contract involving interstate commerce or a maritime transaction "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." (Citations omitted.)

I specifically disagree with the majority opinion's refusal to enforce the agreement to arbitrate in the present case.

Issue I

As stated in the majority opinion: Based on conflict of law principles, is the franchise agreement entered into between the Casarottos and DAI governed by Connecticut law or Montana law?

I point out that the issue as stated by the parties essentially was whether an out-of-state corporation can avoid Montana Arbitration Act's conspicuous notice requirement by claiming preemption under the FAA?

The majority opinion refers to this Court's 1991 case of *Emerson v. Boyd*. In determining whether a contract

dispute arose on an Indian reservation, that case adopted language from *R.J. Williams Co.*, a Ninth Circuit case with regard to the factors to be used to determine whether an action did arise on the reservation. In contrast to the present case, *Emerson v. Boyd* did not contain an agreed choice of law as is present in this case. I do not find this to be appropriate authority.

The majority opinion on this issue concludes that the Montana Legislature had determined that its citizens are entitled to notice before entering into an agreement which will limit their future resolution of disputes to a procedure inconvenient, expensive and devoid of procedural safeguards—and further concludes that the notice requirements of § 27-5-114, MCA, established a fundamental public policy in this State which is contrary to the policy of the Connecticut law. On the basis of those conclusions, the majority opinion further concludes that the law of Montana governs. I do not agree with that conclusion.

The key parts of § 27-5-114, MCA, which apply to this issue are the following:

> Validity of arbitration agreement—exceptions. (1) A written agreement to submit an existing controversy to arbitration is valid and enforceable except upon such grounds as exist at law or in equity for the revocation of a contract.
>
> . . .
>
> (4) Notice that a contract is *subject to arbitration pursuant to this chapter shall be typed in underlined capital letters on the first page* of the contract; and unless such notice is displayed thereon, the contract may not be subject to arbitration. (Emphasis supplied.)

Our question then becomes whether the contract here is subject to "arbitration pursuant to this chapter" so that the notice must be typed in underlined capital letters on the first page of the contract. Two specific paragraphs

of the contract are controlling here. Section 10(c) of the contract stated in pertinent part:

> Any controversy or claim arising out of or relating to this contract or the breach thereof shall be settled by Arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association at a hearing to be held in Bridgeport, Connecticut, . . .

Section 12 of the agreement further stated:

> 12. This Agreement shall be governed by and construed in accordance with the laws of the State of Connecticut and contains the entire understanding of the parties. Other than the representations contained in the Agreement, the Offering Circular and advertising materials of the Franchisor, no other representations have been made to or relied upon by the Franchisee except as set forth below: (None are set forth)

When the foregoing contract provisions are compared to subsection (4) of § 27-2-114, MCA, it is apparent that these contract provisions do not fit within the statute. There is no statement in the Franchise Agreement which specifies that the contract is subject to arbitration pursuant to Montana law or to the Uniform Arbitration Act as enacted in Montana under §§ 27-5-111 to 115, MCA.

I conclude that the contract provisions are controlling in this instance and that the contract between the parties is not by its terms subject to Montana law or arbitration under Montana law. In fact the reverse is true. As above specified, the agreement requires that the commercial rules of the American Arbitration Association shall be applied in any arbitration, and also provides that the agreement is governed by and construed under the laws of the State of Connecticut. This clearly rebuts any suggestion that this particular contract is subject to arbitration pursuant to the laws of the State of Montana and in

particular § 27-5-114, MCA. I therefore conclude that the notice requirement of § 27-5-114, MCA, does not in any way establish a fundamental public policy which is applicable to the present contract.

I further point out that the reference to Restatement (Second) of Conflict of Laws, § 188 (1971), is applicable only in the absence of an "effective" choice of law and I conclude there was such an effective choice of law in the present case.

Issue II

If the contract is governed by Montana law, is the notice requirement of § 27-5-114(4), MCA, of Montana's Uniform Arbitration Act, preempted by the Federal Arbitration Act found at 9 U.S.C. § 1-15 (1988)?

The majority opinion quotes the following from the 1987 United States Supreme Court opinion of *Perry v. Thomas*:

> . . . Congress intended to foreclose state legislative attempts to undercut the enforceability of arbitration agreements. . . . Section 2, therefore, embodies a clear federal policy of requiring arbitration unless the agreement to arbitrate is not part of a contract evidencing interstate commerce . . . *We see nothing in the Act indicating that the broad principle of enforceability is subject to any additional limitations under state law*. . . . (Emphasis supplied.)

The affidavit of the vice president of DAI establishes without contradiction that the present agreement to arbitrate is part of a contract in interstate commerce:

> 5. Before July 1991, DAI was a corporation organized under the laws of the State of Connecticut, with a principal place of business at 325 Bic Drive, Milford, CT 06460. On July 1, 1991, DAI of Florida merged with DAI of Connecticut, leaving DAI of Florida as a surviving corporation.

> 6. DAI has sold a total of 8500 Subway franchises in the United States and estimates that there are approximately 7400 stores in operation world wide.

Clearly the present agreement to arbitrate is part of a contract evidencing interstate commerce so the Federal Arbitration Act is applicable.

The majority opinion analyzes the United States Supreme Court's decision in *Volt* and from that concludes that the nature of the inquiry is whether Montana's notice requirement under § 27-5-114(4), MCA, would undermine the goals and policy of the FAA and further concludes it does not. I disagree with that analysis of *Volt*.

In *Volt*, Volt petitioned the California court to compel arbitration of a dispute and the defendant moved to stay arbitration pursuant to California law. The California statute permitted the court to stay arbitration pending resolution of related litigation between a party to the arbitration agreement and third parties not bound by it. The California court stayed the arbitration proceedings pending the outcome of the litigation. In considering whether the California code section in question was preempted by the FAA, the United States Supreme Court stated:

> The FAA contains no express preemptive provision, nor does it reflect a congressional intent to occupy the entire field of arbitration. . . . But even when congress has not completely displaced state regulation in an area, state law may nonetheless be preempted to the extent that it actually conflicts with federal law—that is, to the extent that it "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." . . . The question before us, therefore, is whether application of Cal. Civ. Proc. Cod. Ann. § 1281.2(c) to stay arbitration under this contract in interstate com-

merce, in accordance with the terms of the arbitration agreement itself, would undermine the goals and policies of the FAA. We conclude it would not.

. . .

. . . Accordingly, we have recognized that the FAA does not require parties to arbitrate when they have not agreed to do so. See id., at 219, 84 L.Ed.2d 158, 105 S.Ct. 1238. (The Act "does not mandate the arbitration of all claims"), nor does it prevent parties who do agree to arbitrate from excluding certain claims from the scope of their arbitration agreement. *It simply requires courts to enforce privately negotiated agreements to arbitrate, like other contracts, in accordance with their terms.* . . (Citations omitted.) (Emphasis supplied.)

Volt, 489 U.S. at 477-78, 109 S.Ct. at 1255, 103 L.Ed. 2d at 499-500. The court further stated and concluded:

> Arbitration under the Act is a matter of consent, not coercion, and parties are generally free to structure their arbitration agreements as they see fit . . . Where, as here, the parties have agreed to abide by state rules of arbitration, enforcing those rules according to the terms of the agreement is fully consistent with the goals of FAA, even if the result is that arbitration is stayed where the Act would otherwise permit it to go forward.

Volt, 489 U.S. at 479, 109 S.Ct. at 1256, 103 L.Ed. at 500. It is essential to keep in mind that the key holding of *Volt* as expressed by the United State Supreme Court was that the agreement to arbitrate should be enforced according to its terms—and that allowed application of the California law which provided for the stay in proceedings where other parties besides the arbitration parties were involved in the case. That conclusion does not assist the majority opinion. The rationale of the *Volt* decision in the present case would require enforcement of the contract as agreed upon by the parties—which would

require application of the American Arbitration Association rules as well as the laws of the State of Connecticut. I conclude that the contract here should be enforced to require application of the American Arbitration Association Rules and the laws of the State of Connecticut under *Volt*.

In addition to the conclusion reached under *Volt*, I will discuss several cases which have concluded that a statutory provision similar to Montana's statutory requirement of a statement in capital letters on page one of a contract is in conflict with the Federal Arbitration Act and therefore not enforceable. In David L. Threlkeld and Co. v. Metallgesellschaft Ltd. (2nd Cir. 1991), 923 F.2d 245, Threlkeld asserted that Vermont law voided any arbitration agreement which does not have a specific acknowledgement of arbitration signed by both parties and where the agreement to arbitrate has not been displayed prominently in the contract. The circuit court acknowledged that Threlkeld was correct in asserting that the contracts did not comply with the rigorous Vermont standard. The circuit court then concluded that the Vermont statute is preempted by federal law and stated:

> Because federal arbitration law governs this dispute, we must determine whether the Vermont statute is sufficiently consistent with federal law that the two may peacefully coexist. . . . The First Circuit has recently held that restrictive provisions similar to those found in the Vermont statute are preempted by federal law. . . .
>
> We agree with the First Circuit that state statutes such as the Vermont statute directly clash with the Convention and with the Arbitration Act because they effectively reincarnate the former judicial hostility towards arbitration. Accordingly *we hold that the Convention and the Arbitration Act preempt the Vermont statute, and that the . . . arbitration pro-*

visions, as drafted, are not enforceable. (Emphasis supplied.)

Threlkeld, 923 F.2d at 250. *Threlkeld* is clear authority for concluding that the Montana statute directly clashes with the Federal Arbitration Act and therefore is not enforceable.

In a similar manner, Bunge Corp. v. Perryville Feed and Produce (Mo.1985), 685 S.W.2d 837, addresses a similar issue. As pointed out by the Missouri court in *Bunge*, the Missouri statute is based on the Uniform Arbitration Act (as is the Montana statute) and contains a provision that each contract shall include a statement in 10 point capital letters which reads substantially as follows: THIS CONTRACT CONTAINS A BINDING ARBITRATION PROVISION WHICH MAY BE ENFORCED BY THE PARTIES. The Missouri Supreme Court then stated:

> It is clear that § 435.460, if applied to this case, seeks to impose a requirement for contracts to arbitrate which is in addition to the requirements of the Federal Arbitration Act. All that is apparently required under that act is contractual language and format sufficient for an ordinary written contract. . . . *If the Missouri statute applies, then a commercial contract sufficient under federal law would be in violation.*

There is a manifest violation of the supremacy clause if our statute is so applied. The Federal Arbitration Act was passed by Congress pursuant to its power to regulate interstate commerce . . . Any requirement of state law which adds a burden not imposed by Congress is in derogation of the Congressional power, and pro tanto invalid. A very recent case so holding is *Southland Corp. v. Keeting*. . .

We do not hold that the Missouri statute is unconstitutional. We simply hold that it may not be

> applied to defeat the arbitration provision of a contract which is within the coverage of the federal statute. . . . (Citations omitted.) (Emphasis supplied.)

Bunge, 685 S.W.2d at 839. The *Bunge* conclusion is directly applicable to our present case. If our Montana statute applies to the present case, then a commercial contract sufficient under federal law would be in violation of the Montana statute even though it meets the requirement of the Federal Arbitration Act. As a result, even if we accept the majority opinion conclusion that the Montana code section applies, I would hold that Montana law may not be applied to defeat the arbitration principles of a contract which is clearly within the coverage of the Federal Arbitration Act.

The District Court held that the Federal Arbitration Act required that the present suit should be stayed until the arbitration has been held in accordance with the terms of the agreement. I would affirm that holding.

/s/ Fred J. Weber
Justice

Chief Justice J. A. Turnage concurs in the foregoing dissent.

/s/ J. A. Turnage
Chief Justice

Justice Karla M. Gray, dissenting.

I respectfully dissent from the Court's opinion on both issues presented therein. I write separately because the reasons for my dissent are not altogether identical to those which form the basis for Justice Weber's dissent.

With regard to issue one, I conclude that the franchise agreement entered into between the Casarottos and DAI was governed by Connecticut law. It is my view that the Court's analysis of this issue is incomplete and erroneous.

I agree with the Court's synopsis of our decision in *Emerson v. Boyd,* and, on the basis that the agreement before us does include a choice of law provision, on the inapplicability of that decision to the case before us. In my view, *Youngblood* also is not on point here, since that case did not relate to whether a statute represents a statement of public policy by the Montana legislature and, if so, the extent of that statement of public policy.

I agree with the Court that Montana has a materially greater interest than Connecticut in the contract issue presented and that, absent an "effective" choice of law by the parties, Montana law would apply. I disagree with the remainder of the Court's discussion and analysis on this issue.

My primary concern is that the Court neither presents nor discusses the specific language contained in the statutory notice requirement. That statute provides that "[n]otice *that a contract is subject to arbitration pursuant to this chapter* shall be typed in underlined capital letters on the first page of the contract; . . . ." Section 27-5-114(4), MCA. By its terms, the franchise agreement before us is subject to Connecticut law, not "this chapter"—the MUAA. The legislature's specific limitation on the applicability of the notice requirement is clear and unambiguous; under such a circumstance, we are obligated to so interpret it (Curtis v. Dist. Court of

21st Jud. Dist. (Mont. 1994), 879 P.2d 1164, 1166, 51 St.Rep. 776, 778) and conclude that the notice requirement is *not* applicable to the contract before us. Since the statute is inapplicable by its terms to the contract, it cannot form the basis of a public policy broad enough to negate the parties' choice of Connecticut law.

The Court does not even address the specific statutory language, preferring to resort inappropriately to generalized legislative history for its overly broad interpretation of the extent to which the notice requirement applies and the extent to which the legislature adopted the notice requirement as a public policy. Had the legislature intended the notice requirement to apply to every arbitration agreement entered into by a citizen or resident of Montana, notwithstanding that some other jurisdiction's law would otherwise apply, it would have done so; it did not. It is inappropriate for the Court to judicially broaden the legislature's clear statute in the guise of a conflict of law analysis.

With regard to issue two, I conclude that even if the Court were correct regarding the applicability of Montana's notice requirement under conflict of law principles, that requirement is preempted by the Federal Arbitration Act (FAA). Therefore, I also dissent from the Court's opinion on this issue.

The Court suggests that the United States Supreme Court's *Volt* decision was a departure from its earlier *Southland/Perry* line of cases. It then presents an inadequate analysis of *Volt*. Finally, the Court concludes, purportedly under a *Volt* analysis, that Montana's notice requirement does not undermine the goals and policies of the FAA. Nothing could be further from the truth.

In *Southland,* the United States Supreme Court was faced with a California statute which required judicial consideration of certain claims brought under it; the California courts held that the statute precluded arbitration

under an agreement containing an arbitration provision. Determining that the FAA was a substantive rule applicable in state courts by which Congress intended "to foreclose state legislative attempts to undercut the enforceability of arbitration agreements," the Supreme Court held that the California statute violated the supremacy clause. *Southland* was decided in 1984.

In 1987, the Supreme Court decided *Perry*, another California case involving a different California statute which—by its terms—provided that legal actions for the collection of wages could be maintained notwithstanding an agreement to arbitrate such claims. Again the California courts denied a motion to compel arbitration under the parties' agreement, favoring their legislature's effort to render arbitration agreements unenforceable. And again the United States Supreme Court reversed, quoting its *Southland* language that Congress intended to foreclose state legislatures from undercutting the enforceability of arbitration agreements. For additional clarity, the Supreme Court added " 'We see nothing in the [FAA] indicating that the broad principle of enforceability is subject to any additional limitations under state law.' " *Perry*, 482 U.S. at 489-90 (citations omitted). *Southland* and *Perry* are, as the Court notes, consistent with each other.

In 1989, the Supreme Court decided *Volt*. There, faced with yet another California statute and another decision from the California courts denying a motion to compel arbitration on the basis of the state statute, the Supreme Court affirmed. Contrary to this Court's suggestion, *Volt* is entirely consistent with—and not a retrenchment from—*Southland* and *Perry*. All three cases require this Court to conclude that Montana's notice requirement is preempted by the FAA.

In *Volt*, the parties had specifically agreed to submit disputes under their contract to arbitration under the California arbitration statutes. The California arbitration

statute at issue in *Volt* differed markedly from those in *Southland* and *Perry*. As noted above, the earlier cases involved statutes which clearly undercut the enforceability of arbitration agreements. In *Volt*, however, the statute—part of the California Arbitration Act—merely allowed a court to *stay* arbitration pending resolution of related litigation; the right to arbitrate remained. The issue before the Supreme Court was the same as in the earlier cases: whether the stay provision would undermine the goals and policies of the FAA.

The Supreme Court reiterated that the purpose of the FAA was to *enforce* arbitration agreements entered into by parties, and specifically noted the parties' agreement to apply California's arbitration rules, one of which permitted the stay of arbitration pending related litigation. On these facts, including the parties' choice of California arbitration law and that that law permitted a stay—but not a voiding—of arbitration, the Supreme Court held that enforcing the California stay provision did not frustrate the policy behind the FAA of enforcing arbitration agreements.

The Court's opinion fails—or refuses—to recognize two important differences between *Volt* and the case presently before us. First, the Supreme Court in *Volt* relied heavily on the fact that the parties had affirmatively chosen California arbitration law, including the stay statute, to govern their agreement. Second, the stay statute did not undercut, undermine or render unenforceable the parties' agreement to arbitrate.

Here, the parties did not affirmatively choose Montana arbitration law, which includes the notice requirement, to govern their agreement. They chose Connecticut law.

Moreover, it is clear under *Southland*, *Perry* and *Volt* that Montana's notice requirement is preempted by the Federal Arbitration Act. The reason for this constitutes the second important difference between this case and

Volt: here, the application of the notice requirement is not merely a procedural matter; indeed, it totally undermines the purposes of the FAA by rendering the parties' arbitration agreement unenforceable. This is precisely the result prohibited by the United States Supreme Court in all three of the cases discussed herein and in the Court's opinion on this issue.

I would affirm the District Court's grant of defendants' motion to stay judicial proceedings pending arbitration of plaintiffs' claims.

/s/ Karla M. Gray
Justice

Chief Justice J.A. Turnage joins in the foregoing dissent of Justice Karla M. Gray.

/s/ J.A. Turnage
Chief Justice

APPENDIX C

[Filed Feb. 17, 1994]

IN THE SUPREME COURT
OF THE STATE OF MONTANA

No. 93-488

PAUL CASAROTTO and PAMELA CASAROTTO,
Plaintiffs and Appellants,

v.

NICK LOMBARDI and DOCTOR'S ASSOCIATES, INC.,
Defendants and Respondents,

and

DANIEL L. and DEB HUDSON, and
D&D SUBWAY CORPORATION,
Defendants.

ORDER

Pursuant to the Internal Operating Rules of this Court, this cause is classified for oral argument before the Court sitting en banc and will be set on a future calendar of this Court.

IT IS ORDERED that counsel for all parties in this appeal are hereby directed to specifically address in oral argument the issue of preemption in the following United States Supreme Court case: *Volt Information Sciences, Inc. vs. Board of Trustees of the Leland Stanford Junior University* (1989), 489 U.S. 468, 103 L.Ed.2d 488, 109 S.Ct. 1248.

This Court will consider receiving amicus curiae briefs relative to this cause.

The Clerk is directed to mail a true copy of this order to counsel of record for all parties and to the Executive Directors of the State Bar of Montana, the Montana Trial Lawyers' Association and the Montana Defense Trial Lawyers' Association.

DATED this 17th day of February, 1994.

For the Court,

By /s/ J.A. Turnage
Chief Justice

APPENDIX D

[Filed Jun. 2, 1993]

MONTANA EIGHTH JUDICIAL DISTRICT COURT
CASCADE COUNTY

No. BDV-92-860

PAUL CASAROTTO and PAMELA CASAROTTO,
Plaintiffs,

vs.

DANIEL L. and DEB HUDSON,
D&D SUBWAY CORPORATION, NICK LOMBARDI,
and DOCTOR'S ASSOCIATES, INC.,
Defendants.

ORDER

This cause is before the Court on the defendants Doctor's Associates, Inc. ("DAI") and Nick Lombardi's motion to dismiss, or in the alternative, to stay pending arbirtation. The Court having considered the briefs, the argument of counsel and the evidence submitted, rules as follows:

1. The plaintiff Paul Casarotto (the "franchisee") and DAI entered into a franchise agreement dated April 25, 1988 that concerned interstate commerce. DAI is the national franchisor of "Subway" sandwich shops and the franchise agreement permits, *inter alia*, the franchisee a license to use the nationally-known and federally-registered "Subway" trademark.

2. The franchise agreement contained a clause requiring that:

> Any controversy or claim arising out of or relating to this contract or the breach thereof shall be settled by Arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association at a hearing to be held in Bridgeport, Con-

necticut and judgment upon an award rendered by the Arbitrator(s) may be entered in any court having jurisdiction thereof. The commencement of arbitration proceedings by an aggrieved party to settle disputes arising out of or relating to this contract is a condition precedent to the commencement of legal action by either party. The cost of such a proceeding will be borne equally by the parties.

3. The claims asserted by the plaintiffs against defendants DAI and its alleged agent Lombardi arise out of and relate to the franchise agreement and are therefore encompassed by the arbitration clause and referable to arbitration.

4. The Federal Arbitration Act requires that if an action is brought upon any issue referable to arbitration under the terms of an arbitration agreement, the suit shall be stayed "until such arbitration has been had in accordance with the terms of the agreement. . . ." 9 U.S.C. § 3. *See also, e.g., Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 24-25 (1983); *Downey v. Christensen*, 825 P.2d 557, 559 (Mont. 1992).

5. DAI has demanded arbitration of the plaintiffs' claims under the rules of the American Arbitration Association.

Accordingly, it is ordered and adjudged that plaintiffs' claims against the defendants Doctor's Associates, Inc., and Nick Lombardi are hereby stayed until the arbitration has been had in accordance with the terms of the arbitration agreement.

DONE and ORDERED this 2nd day of June, 1993.

/s/ John M. McCarvel
District Judge

APPENDIX E

STATUTE INVOLVED

Section 27-5-114, Montana Code Annotated

27-5-114. Validity of arbitration agreement—exceptions. (1) A written agreement to submit an existing controversy to arbitration is valid and enforceable except upon such grounds as exist at law or in equity for the revocation of a contract.

(2) A written agreement to submit to arbitration any controversy arising between the parties after the agreement is made is valid and enforceable except upon such grounds as exist at law or in equity for the revocation of a contract. Except as permitted under subsection (3), this subsection does not apply to:

(a) claims arising out of personal injury, whether based on contract or tort;

(b) any contract by an individual for the acquisition of real or personal property, services, or money or credit where the total consideration to be paid or furnished by the individual is $5,000 or less;

(c) any agreement concerning or relating to insurance policies or annuity contracts except for those contracts between insurance companies; or

(d) claims for workers' compensation.

(3) A written agreement between members of a trade or professional organization to submit to arbitration any controversies arising between members of the trade or professional organization after the agreement is made is valid and enforceable except upon such grounds as exist at law or in equity for the revocation of a contract.

(4) Notice that a contract is subject to arbitration pursuant to this chapter shall be typed in underlined capital letters on the first page of the contract; and unless such notice is displayed thereon, the contract may not be subject to arbitration.